UNIVERSITY OF BOLTON

MSc ACCOUNTANCY and FINANCIAL MANAGEMENT

SEMESTER 2 EXAMINATIONS 2018/2019

STRATEGIC BUSINESS REPORTING

MODULE NO: ACC7520

Date: Wednesday 22 May 2019 **Time: 2.00 – 5.00**

INSTRUCTIONS TO CANDIDATES:

There are 4 questions in this examination; answer ALL 4 questions.

This is a closed book examination.

You must hand in this exam paper with your answer booklet.

Answers must be in black or blue ink ONLY.

QUESTION 1 The following financial statement **extracts** relate to the Hessian Group:

Extracts from statement of financial position as at 30 April 2019 (with comparatives)

	2019	2018
	£m	£m
Non-current assets		
Goodwill	136	127
Current assets		
Inventories	167	156
Trade and other receivables	219	197
Current liabilities		
Trade and other payables	140	100

Extract from statement of profit or loss for the year ended 30 April 2019

	£m
Gross profit	966
Operating expenses	(751)
Finance costs	(5)
Profit before tax	210

The following information is relevant to the Hessian group:

(i) Depreciation charged on property, plant and equipment for the year ended 30 April 2019 was £196 million.

(ii) On 1 May 2018, the Hessian group acquired 70% of the shares in Natural. Consideration for the share purchase was in two forms:

- cash of £80 million
- an intangible asset with a fair value of £6 million and a carrying amount of £4 million.

Hessian measured the non-controlling interest in Natural at its fair value of £40 million at the acquisition date. The fair value of Natural's identifiable net assets at the acquisition date was £110 million. This included the following

	£m
Inventories	15
Trade and other payables	7

Goodwill impairments have been recorded in the year, but do not relate to Natural.

Question 1 continues over the page

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Question 1 continued

(iii) Hessian has a defined benefit pension scheme, presented in non-current liabilities. The year-on-year movement comprises the following

	£m
Net obligation at 30 April 2018	90
Net interest cost	2
Current service cost	8
Contributions to scheme	(9)
Remeasurement loss	4
Net obligation at 30 April 2019	95

The benefits paid in the period by the trustees of the scheme were £4 million. The net interest cost has been charged to finance costs. The current service cost has been charged to operating expenses.

Required:

(a) (i) Using the indirect method calculate 'cash generated from operations' as it would appear in the consolidated statement of cash flows for the year ended 30 April 2019. Explain the reasoning behind the adjustments that you make to profit.
(14 marks)

(ii) Discuss the extent to which the indirect method of reporting cash flows from operating activities is more useful and informative to users of financial statements than the direct method. (8 marks)

Shortly after the reporting period Hessian sold 49% of the ordinary shares of a previously wholly owned subsidiary, Patten, to a third party, Manis. The directors of Hessian believe that they should continue to account for the remaining investment in Patten as a subsidiary in the consolidated financial statements. Hessian is permitted to appoint three out of four directors to Patten's board. Under the shareholder agreement with Manis, consensus is required with respect to:

- significant changes in Patten's activities
- plans or budgets that deviate from Patten's business plan
- Patten's accounting policies; acquisition of assets above a certain value; employment or dismissal of senior employees; distribution of dividends or establishment of loan facilities

Required:

(b) Discuss how Hessian should account for its remaining holding in Patten's ordinary shares in the consolidated financial statements. (8 marks)

(Total: 30 marks)

End of question 1

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Question 2

Sonata is a public limited entity with a reporting date of 31 December 2019. Sonata has requested a new loan from its existing bank. The bank would like to review the consolidated financial statements for the year ended 31 December 2019 as well as the separate (non-consolidated) financial statements of Sonata for the same period. A new accountant has recently started working at Sonata.

Impairment

During the prior period, Sonata purchased 75% of the ordinary shares of Melody. The non-controlling interest was valued at acquisition using the 'proportion of net assets' method. Goodwill arising on the acquisition was correctly calculated as £9 million. No impairments have been recorded to-date. As at 31 December 2019, the carrying amount of the net assets of Melody in the consolidated statements was £60 million (excluding goodwill). The finance director has told the accountant that Melody's financial performance is strong and that a goodwill impairment review is not required. However, the accountant has discovered correspondence between the directors stating that Melody's post-acquisition performance is disappointing and that the recoverable amount of Melody's net assets is £68 million.

Disclosure

Sonata owns 100% of the ordinary shares of Tune. Sonata sold goods to Tune during the current period at a 60% mark-up. Similar goods are usually sold to other parties at a mark-up of 20%. The accountant has expressed concern about the fact that non-market rates are charged. However, the finance director says that no ethical issues arise because the transaction will be eliminated from the consolidated financial statements. The finance director has told the accountant to omit any reference to these transactions in Sonata and Tune's separate financial statements.

Lease

While filing invoices, Sonata's accountant found a lease agreement that allows Sonata to use a specialised machine for two years. The lease commenced on 31 December 2019. Sonata must make annual payments of £2 million. The first payment commences on 31 December 2020. The interest rate implicit in the lease is 6%. No accounting entries have been posted. The accountant queried this accounting treatment, but the finance director became angry and threatened the accountant with disciplinary action on the grounds that she was not a 'team player'.

Required:

Discuss the ethical and accounting implications of the above from the perspective of the accountant.
(18 marks)

Professional marks will be awarded in question 2 for the application of ethical principles.
(2 marks)

(Total: 20 marks)

End of Question 2

Please turn the page

Question 3

(a) Formatt is a listed company that prepares financial statements in accordance with International Financial Reporting Standards. The reporting date is 31 March 2019.

(i) Formatt has entered into a contract with a customer to supply specialised medical equipment. Formatt has developed the equipment in conjunction with the customer but has contracted with a supplier for its manufacture. The supplier delivers the equipment to the customer. Formatt pays the supplier directly and invoices the customer with the agreed selling price which is cost plus 25%. Any equipment defects are the responsibility of Formatt.

The directors of Formatt are unsure as to whether they should account for the whole transaction as a principal or just a commission as if an agent. **(6 marks)**

(ii) Formatt acquired a cash-generating unit (CGU) several years ago. At 31 March 2019, the directors of Formatt were concerned that the value of the CGU had declined because of a reduction in sales due to new competitors entering the market. At 31 March 2019, the carrying amounts of the assets in the CGU before any impairment testing were:

	£m
Goodwill	3
Property, plant and equipment	10
Intangible assets	18
Cash	1
	32

The total fair value of the CGU's assets at 31 March 2019 was £27 million and costs to sell were £400,000.

The CGU's cash flow forecasts for the next five years are as follows:

Year ended	Pre-tax cash flow £m
31 March 2020	8
31 March 2021	7
31 March 2022	5
31 March 2023	3
31 March 2024	13

The pre-tax discount rate for the CGU is 8%.

The directors of Formatt need advice about accounting for the impairment of the CGU. **(8 marks)**

Required:

Respond to the directors' requests.

Note: the mark allocation is shown against each of the two situations above.

Question 3 continues over the page – Please turn the page

Question 3 continued

At the Annual General Meeting, the shareholders complained that Formatt's financial statement disclosure notes are poorly presented and confusing. The shareholders argued that it was difficult to find relevant information due to the high volume of information disclosed. The directors want to produce useful financial statement disclosure notes and require advice about the issues they should consider.

Required:

(b)With reference to the Board's Principles of Disclosure Project, respond to the directors' request.
(11 marks)

(Total: 25 marks)

End of question 3

Question 4

There is no accepted definition of 'financial' capital, although it is often interpreted as including equity and some forms of debt. An understanding of what an entity views as capital and its strategy for capital management is therefore important for current and potential investors. When issuing financial instruments, entities must carefully consider classification as either debt or equity because this has a significant effect on reported results and financial position.

Required:

(a)

(i) Discuss why the information about the capital of a company is important to investors. Your answer should briefly discuss how the International Integrated Reporting Framework conceptualises 'capital'. **(5 marks)**

(ii) Discuss the importance of the classification of equity and liabilities under International Financial Reporting Standards and how this classification has an impact on the information disclosed to users in the statement of profit or loss and other comprehensive income and the statement of financial position. **(6 marks)**

Question 4 continues over the page

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Question 4 continued

Amster issued preference shares at a fair value of £75 million on 30 November 2019. Amster is currently presenting these as liabilities. These shares pay holders a cash dividend of up to 8% per annum of the issue price of each preferred share. The company may pay all, part or none of the dividend in respect of each preference share, based on the decision of the management committee. The preference shares can be redeemed but only on the approval of the management committee.

On 1 December 2018, Amster granted 250 cash-settled share awards to each of its 1,500 employees on the condition that the employees remain in its employment for the next three years. Cash is payable at the end of three years based on the share price of the entity's shares on that date. During the year to 30 November 2019, 65 employees left and, at the reporting date, Amster estimated that an additional 115 employees will leave during the following two years. The fair value of each award on 1 December 2018 and 30 November 2019 was £30 and £35 respectively. It is anticipated that the fair value will rise to £46 per right by 30 November 2021. In respect of this scheme, Amster has charged the expense to profit or loss and credited shareholders' equity with the same amount.

The capitalisation table of Amster as at 30 November 2019 is set out below:

	£m
Bank loans	81
Pension plan deficit	30
Preference shares	75
Total long-term liabilities	186
Non-controlling interest	10
Shareholders' equity	150
Total group equity	160
Total capitalisation	346

Required:

(b)Discuss whether the accounting treatment of the above transactions is acceptable under International Financial Reporting Standards. You should adjust the draft capitalisation table and discuss the effect on the gearing and the return on capital employed ratios. (12 marks)

Professional marks will be awarded in question 4 for clarity and quality of presentation. (2 marks)

(Total: 25 marks)

End of question 4

END OF QUESTIONS