Strategic Professional – Essentials

Strategic Business Reporting – International (SBR – INT)

Time allowed: 3 hours 15 minutes

ALL questions are compulsory and MUST be attempted

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted
Section B – BOTH questions are compulsory and MUST be attempted

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

SBR - INT

Section A – BOTH questions are compulsory and MUST be attempted

Question 1:

Acquisition of flower

On 1 December 2018, Phool acquired 60% of the equity interests of Flower, a public limited company for cash of $500 million. At acquisition, the fair value of the non-controlling interest in Flower was $395 million. Phool wishes to use the 'full goodwill' method for recognizing the goodwill of Flower. On 1 December 2018, the fair value of the identifiable net assets acquired was $830 million, while the carrying value of net asset of Flower was $800 million which includes share capital of $1, $100 million, retained earnings of Flower were $450 million and other components of equity were $250 million. The excess in fair value of the identifiable assets is due to plant which has a remaining life of 5 years at acquisition date.

On 31 May 2019, Phool acquired a further 10% interest in Flower for a cash consideration of $220 million when the net assets of Flower were $870 million after fair value adjustment but before the depreciation impact as the result of fair value adjustment

At 30 November 2019 the fair value of net assets after all fair value and their resulting depreciation impact are $950.

Dhakan acquisition

On 1 December 2018, acquisition of 10% of the equity shares of Dhakan. Phool had treated this investment as per IFRS 9 default category.

On 31 May 2019, acquisition of a further 65% of the equity shares of Dhakan, obtaining control.

	Shareholding	*Consideration*
	%	$m
1 November 2018	10	6
31 May 2019	65	42
	75	48

At 31 May 2019, the fair value of the equity interest in Dhakan before the business combination was $9 million.

The non-controlling interest fair value was measured at acquisition to $18 million so Phool limited decided to carry full goodwill in relation to Dhakan limited.

The fair value of the identifiable net assets before the deferred tax impact at 1 December 2008 of Dhakan was $36 million, and the difference between carrying value in excess of the fair value of the net assets was due to an increase in the value of property, plant and equipment (PPE), which was provisional pending receipt of the final valuations. These valuations were received on 30 April 2019 and resulted in an additional increase of $5 million in the fair value of PPE at the date of acquisition. This increase does affect the fair value of the non-controlling interest at acquisition which increase by $2 million from acquisition date.

The tax base of net asset at acquisition date was $35 million and tax rate were 30%.

Disposal of Handsome

Phool acquired an 80% controlling interest in Handsome limited a public entity whose main business is to sell gym equipment on 1 April 2013. Goodwill at acquisition was valued as 3 times multiple of their 5 years average profit and average profit was $10 million.

Due to more competition sales are declining during past years due to which entity goodwill suffered an impairment loss of 50%. On 30 may 2019 entity disposed 60% stake in Handsome limited for $65 million when the net assets of that entity other than goodwill were $45 million and NCI was valued at disposal date $11 million. Remaining 20% stake left in Handsome has a fair value was $20 million.

Handsome is still able to exert significant influence over Handsome.

At year end net assets of Handsome limited was $42 million.

Required:

a) **Explain to the directors of Phool, with appropriate calculation, how goodwill should be calculated on the acquisition of Flower and Dhakan**

(10 marks)

b) **Calculate and explain the Non-controlling interest in flower at year ended 30 November 2019.**

(8 marks)

c) **Explain to the directors of Phool the accounting treatment of disposal of Handsome and what is the carrying value of investment in handsome at year end 30 November 2019 in consolidated financial statements.**

(12 marks)

Total (30 marks)

Question 2:

Fourmile is a public entity sells toys and children accessories and had a unique style of products. They sell through its own retail shops all over the country and has good presence in all major cities' malls and market.

Company has bonus scheme where some directors are being paid 2% of sales as a bonus every year while some are getting bonus on the basis of profit, although entity has not contractual obligation to pay such a bonus but it is company practice to give them sales-based bonus since its incorporation.

1) The new accountant who recently joined the Fourmile and responsible for the preparation of financial statements is reviewing and observed two transactions are inaccurately presented but reluctant to talk to seniors and he know bonus based on sales.

Fourmile sold an item of plant for $60 million while its fair value was $48 million on 1 April 2018 and 60 million is included amount is in sales figure. The plant had a carrying amount of $40 million at the date of sale, which was charged to cost of sales. On the same date, Fourmile entered into an agreement to lease back the plant for the next 8 years (being the estimated remaining life of the plant) at a cost of $10 million per annum payable annually in arrears. An arrangement of this type is normally deemed to have a financing cost of 8% per annum. Fourmile retained the rights to direct the use of and retain substantially all the remaining benefits from the plant.

2) Recently Fourmile was contacted by customized toy manufacturer, Educationist, who sells toys to different schools that helps in education according to the needs of specific school. They reached to an agreement to take and deliver orders from all the toy shops of Fourmile. Educationist is responsible for accepting the orders or amendments in design if not according to the given design and the selling price is solely at discretion of Educationist .Response from all the cities are very good and they made a sale of $50 million and Fourmile paid $40 million to the educationist and retained the remaining amount as per decided rate of 20%. Amounts are included in sales and cost of sales respectively inventory from educationist still included in shops of Fourmile are $5 million waiting for customers to accept.

Inventory is also included in Fourmile inventory in statement of financial position.

Required:

Discuss the ethical and accounting implications of the above situations from the perspective of the accountant.

(15 marks)

Professional marks will be awarded for the quality of discussion.

(5 marks)

Total (20 marks)

Section B – BOTH questions are compulsory and MUST be attempted

Question 3:

Butt limited a public listed entity is a manufacturing entity and seeking to determine the fair value related to some asset acquired in a business combination and a customized machine.

Busy limited group of assets

Butt limited acquires another entity with the name of busy limited, all its assets and assumed liabilities in a business combination. One of the groups of assets acquired comprises a component of property, plant and equipment (PPE), land and a software which is a billing software integral to the business developed by the acquired entity for its own use in conjunction with a land and PPE. The Butt limited measures the fair value of each of the assets individually, consistent with the specified unit of account for the assets. The entity determines that the highest and best use of the assets is their current use and that each asset would provide maximum value to market participants principally through its use in combination with other assets or with other assets and liabilities (its complementary assets and the associated liabilities). There is no evidence to suggest that the current use of the assets is not their highest and best use.
The entity can sell this group of assets to two types of buyers:

(a) Its competitors have substitute assets; software would not be used for its full remaining economic life. The indicated fair values of PPE, land and software within the competitor's asset group (reflecting the synergies resulting from the use of the assets within that group) are $100 million, $260 million and $30 million respectively. The indicated fair value of the assets as a group within the competitor's buyer asset group is $390 million.

(b) Financial buyer asset group. The entity determines that financial buyers aren't related or substitute assets that would enhance the value of the group within which the assets would be used. Because financial buyers do not have substitute assets, software (billing software) would be used to its full remaining economic life. The indicated fair values of PPE, land and software within the financial buyer asset group are $100 million, $200 million and $60 million, respectively. The indicated fair value of the assets as a group within the financial buyer asset group is $360 million.

Butt limited accountants are confused weather to assess the fair value as a group of assets or on individual basis.

Customized machine

Butt limited acquires a machine in a business combination. The machine will be held and used in its operations. The machine was originally purchased by the entity from an outside vendor and, before the business combination, was customized by the acquired entity for use in its operations. However, the customization of the machine was not extensive. The acquiring entity determines that the asset would provide maximum value to market participants through its use in combination with other assets or with other assets and liabilities (as installed or otherwise configured for use). There is no evidence to suggest that the current use of the machine is not its highest and best use. Therefore, the highest and best use of the machine is its current use in combination with other assets or with other assets and liabilities.

The machine does not have a separate identifiable income stream from which to develop reliable estimates of future cash flows. Furthermore, information about short-term and intermediate-term lease rates for similar used machinery that otherwise could be used to project an income stream (I lease payments over remaining service lives) is not available.

Quoted prices for similar machines adjusted for differences between the machine (as customized) and the similar machines. The measurement reflects the price that would be received from the machine in its current condition (used) and location (installed and configured for use). The fair value indicated by that approach ranges from \$41 million to \$47 million

Entity estimate of the amount that would be required currently to construct a substitute (customized) machine of comparable utility. The estimate takes into account the condition of the machine and the environment in which it operates, including physical wear and tear (physical deterioration), improvements in technology (functional obsolescence), conditions external to the condition of the machine such as a decline in the market demand for similar machines (economic obsolescence) and installation costs. The fair value indicated by that approach ranges from \$41 million to \$51 million.

Accountants are confused about the valuation techniques available for fair value measurement as per IFRS 13 and the choice of appropriate technique for fair valuation of customized machine and how the IFRS 13 application would be different if customization of machine was extensive and seeking for your advice on this matter.

Required:

a) **Discuss different valuation techniques and their application for calculation of fair value as per IFRS 13.**

(8 marks)

b) **Assess the fair value of** a group **of assets on acquisition of Busy limited and** customized **machine.**

(10 marks)

c) **Discuss why many users of financial statements believe that fair value is a more appropriate measure for assets rather than historical cost and some of them contradict as well.**

(7 marks)

Total (25 marks)

Question 4:

You are the consultant of Carrie limited, a public entity, seeking your advice on the following matters.

Their year-end is 31 December 2019:

a) Carrie enters into a 10-year lease of the property on 1 January 2019 with annual lease payments of $50,000, payable at the start of each year. The contract specifies that the lease payments will increase every two years on the basis of the increase in the Consumer Price Index (CPI) for the preceding two years.

The CPI at 1 January 2019 is 125. The rate implicit in the lease is not readily determinable. Carrie's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Carrie could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Carrie makes the lease payment for the first year and measures the present value of the remaining nine payments of $50,000, discounted at the interest rate of 5 per cent per annum, which is $355,391. Carrie expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

At the beginning of third year it is expected that CPI will change to 135, before accounting for the change in future lease payments resulting from a change in the Consumer Price Index and making the lease payment for the third year, the lease liability is $339,319 (the present value of eight payments of $50,000 discounted at the interest rate of 5 per cent per annum = $355,391 + $33,928 – $50,000). The relevant annuity factor at the start of year 3 at 5% interest rate is 6.78637

Now they are seeking your advice on initial measurement of Right of use asset, lease liability and when and how to reassess lease liability subsequently and application of IFRS 16 on above situation. **(12 marks)**

b) Carrie, is planning to start a new business in a different region with a single shareholder on 1 January 2019. Carrie purchased an item of inventory for $1,000 and sold that inventory for cash for $1,400. At the end of 31 December 2019, the replacement cost of the same item of inventory is $1,100. General inflation during the year was 7%.

For the better understanding of shareholder Carrie wants you to calculate profit for the year and set out a summary statement of financial position as of 31 December 2019 under the following capital maintenance concepts in IASB framework.

(i) Physical capital maintenance.

(ii) Financial capital maintenance if chooses Historical cost accounting. **(5 marks)**

c) Directors of Carrie have recently been asked about presenting some additional performance measures for the year ended 31 December 2019 in their financial statement now they are keen in knowing about the possible advantages and disadvantages of presenting additional performance measures and precautions to follow in presenting those measures.

(8 marks)

Total (25 marks)