FINANCIAL REPORTING - FINAL EXAM

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Date: March 24, 2012

Duration: 2H and 30 Min

GROUP I

(4 points – 45 minutes)

The below information pertains to company X.

Assume that all income and expenses are treated identically for tax and accounting purposes ***except*** **impairment losses**. Consider that all income and expenses (except depreciation, impairment losses and taxes) are immediate cash transactions.

In 2010, the company accounted for 1.000 € of Impairment losses which were related to Accounts receivable. Management considers that there is a significant credit risk associated to certain debtors and that the value should be fully impaired in the first year. However, for tax purposes only the following amounts are acceptable: 25% in the first year, 50% in the second year and 25% in the third year. Assume a tax rate of 25% and consider that Income taxes recognized in an Income Statement are paid in the beginning of the following year.

Determine, for the four years under analysis:

1. The Income tax values that will be placed in the Income statement.
2. The Balance sheet tax position.

ACCOUNTING VALUES

values in euros

Consolidated Income Statement

	2010	2011	2012	2013
Revenue	5.000	5.000	5.000	5.000
Other net gains	500	500	500	500
Raw materials and consumables used	-1.000	-1.000	-1.000	-1.000
Supplies and services	-700	-700	-700	-700
Depreciation expense	-600	-600	-600	-600
Provision expense				
Interest expense	-200	-200	-200	-200
Profit before tax				
Income tax				
Profit after tax				

Current tax

Deferred tax asset

TAX PURPOSE

Consolidated Income Statement

	2010	2011	2012	2013
Revenue	5.000	5.000	5.000	5.000
Other net gains	500	500	500	500
Raw materials and consumables used	-1.000	-1.000	-1.000	-1.000
Supplies and services	-700	-700	-700	-700
Depreciation expense	-600	-600	-600	-600
Provision expense				
Interest expense	-200	-200	-200	-200
Profit before tax				
Income tax				
Profit after tax				

Statement of Financial Position	2010	2011	2012	2013
Assets: Tax position				
Liabilities: Tax position				

GROUP II

(3,0 points – 15 minutes)

EASYJET 2011 report informs that:

Employee benefits
easyJet contributes to defined contribution pension schemes for the benefit of employees. easyJet has no further payment obligations once the contributions have been paid. The assets of the schemes are held separately from those of easyJet in independently administered funds. easyJet's contributions are charged to the income statement in the year in which they are incurred.
The expected cost of compensated holidays is recognised at the time that the related employees' services are provided.

Share-based payments
easyJet has a number of equity-settled share incentive schemes. The fair value of share options is measured at the date of grant using the Binomial Lattice option pricing model. The fair value of awards under the Long Term Incentive Plan and Share Incentive Plan is the share price at the date of grant.
The fair value of the estimated number of options and awards that are expected to vest is expensed to the income statement on a straight-line basis over the period that employees' services are rendered, with a corresponding increase in shareholders' equity. Where performance criteria attached to the share options and awards are not met, any cumulative expense previously recognised is reversed.

Employee costs for easyJet were:

	2011 £ million	2010 £ million
Wages and salaries	**350**	300
Social security costs	**48**	39
Pension costs	**28**	23
Share-based payments	**6**	5
	432	367

Consider that wages and salaries include performance bonus.

17 Share capital

	Number		Value	
	2011 million	2010 million	**2011 £ million**	2010 £ million
Authorised				
At beginning and end of the year; ordinary shares of 25p each	**500**	500	**125**	125
Allotted, called up and fully paid				
At 1 October	**430**	425	**107**	106
Issued during the year under share incentive schemes	**1**	5	**1**	1
At 30 September	**431**	430	**108**	107

1. Using the above information, make a comment on the importance of the different remuneration policies.

2. What is the meaning of *".. easyJet contributes to defined contribution pension schemes"* and why does *"easyJet has no further payment obligations once the contributions have been paid."*

3. Would it be possible to find, in easyJet Statement of Financial Position, a liability or and asset related to Pensions? Justify your answer.

4. Explain how the different remunerations schemes mentioned above should be accounted for in the group's financial statement position. For share based payments explain which annual adjustments are considered and what is recognized when the shares are finally granted.

GROUP III

(4,5 points – 15 minutes)

1. Explain the meaning of Fraud triangle.

2. What are the risks and rewards involved in Whistleblowing?

3. In the presentations made in class about Fraudulent reporting, it was frequent to find strong references to Special Purposes Entities. Explain why and identify three cases where these entities were used.

GROUP IV

(8,5 points – 60 minutes)

Page 6 presents the Financial Statements of companies **A, B and C**, as of 31.12.2011.

On January 1, 2008, Company **A** paid 140.000 t€ for 50% of **B** shares. At the acquisition date, the balances on the Share capital and the Retained earnings of **B** were 100.000 t€ and 20.000 t€, respectively. **A** has power over more than half of the voting rights by virtue of an agreement with another investor which holds 25% of **B** shares. At the acquisition date, the fair value of **B**'s tangible assets (land) was 8.000 t€ higher than the book value and **B** brands were identified and measured at a total value of 120.000 t€.

On January 1, 2009, company **A** acquired 25% of company **C** for 200.000 t€, when C's share capital was 500.000 t€ and retained earnings were 150.000 t€. The parent company used the cost model to measure the financial investments in its Separate financial statements, in accordance with IAS 27, paragraph 38:

> ***38*** *When an entity prepares separate financial statements, it shall account for investments in subsidiaries, jointly controlled entities and associates:*
>
> *(a) at cost, or*
>
> *(b) in accordance with IAS 39.*
>
> *The entity shall apply the same accounting for each category of investments.*

During the year 2011:

- **A** received 20.000 t€ of dividends from **B** and 30.000 t€ from **C**.
- **A** sold to **B** merchandise for 80.000 t€ that had initial cost of 60.000 €. At December 31, 100% of these goods had been sold by B to companies outside the group.

1. Draw a graphical presentation of the group's structure and define the consolidation methods that should be used.

2. Use the attached answer sheet and prepare the Consolidated Statement of Financial position. Explain the calculations and the meaning of namely:

    a. Goodwill
    b. Share capital
    c. Retained earnings
    d. Net profit
    e. Minority interests.

STATEMENTS OF FINANCIAL POSITION AT 31 DECEMBER 2011					
	A	**B**	**C**	**Eliminate**	**CBS**
ASSETS					
Non-current assets					
Goodwill					
Intangible assets					
Tangible assets	550.000	160.000	800.000		
Investment in B	140.000				
Investment in C	200.000				
Current assets:					
Inventories	120.000	30.000	250.000		
Trade receivables	80.000	20.000	180.000		
Current Account - A		30.000			
Current Account - A			100.000		
Deferred taxes		2.500			
Bank	25.000	20.000	50.000		
Total assets	1.115.000	262.500	1.380.000		
EQUITY AND LIABILITIES					
Share capital	400.000	100.000	500.000		
Retained earnings	-120.000	25.000	200.000		
Net profit	60.000	-7.500	165.000		
	340.000	117.500	865.000		
Non-controlling interests					
Non-Current liabilities:					
Bank loans	510.000	0	0		
Current liabilities:					
Trade payables	115.000	145.000	460.000		
Current Account - B	30.000				
Current Account - C	100.000				
Taxation	20.000		55.000		
Total equity and liabilities	1.115.000	262.500	1.380.000		

INCOME STATEMENTS FOR 2011					
	A	**B**	**C**	**Eliminate**	**CBS**
Sales	1.200.000	300.000	1.500.000		
Cost of sales	-600.000	-150.000	-750.000		
Other operating expenses	-250.000	-150.000	-280.000		
Operating profit	350.000	0	470.000		
Dividends received from B	20.000				
Dividends received from C	30.000				
Gains and losses in Associated companies					
Interest expenses	-320.000	-10.000	-250.000		
Profit before tax	80.000	-10.000	220.000		
Income tax expense	-20.000	2.500	-55.000		
Net profit for the year	60.000	-7.500	165.000		
Shareholders of the parent company					
Non-controlling interests					