CATÓLICA LISBON

International Financial Reporting Standards

FINAL EXAM

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Date: October 26, 2012

Duration: 2 hours and 15 minutes

GROUP I

(5 points – 20 minutes)

Choose the correct answer and **justify** your choice.

1. Providing information about the performance and financial position of companies so that users can make economic decisions best describes the role of:

   A. Auditing.

   B. Financial reporting.

   C. Financial statement analysis.

2. US Financial Accounting Standards are currently developed by which entity:

   A. The United States Congress.

   B. The Financial Services Authority.

   C. The Financial Accounting Standards Board.

3. According to IAS 1, a complete set of financial statements, has the following components:

   A. statement of financial position, income statement and statement of cash-flow.

   B. statement of financial position, comprehensive income statement, statement cash-flow and statement of changes in equity.

   C. None of the above alternatives.

4. How would the collection of accounts receivable (receiving the amount in accounts receivable) *most likely* affect the current and cash ratios?

	Current ratio	Cash ratio
A.	Increase	Increase
B.	Increase	No effect
C.	No effect	Increase
D.	No effect	No effect

5. Company A acquired company B. Determine Goodwill knowing that at the date of acquisition:

Cost of acquisition	1.000
Accounting value of assets and liabilities of B	300
Fair value of previously identifiable assets and liabilities of B	500
Fair value of newly identifiable assets and liabilities of B (Brands)	100

A. 400.

B. 500.

C. 700.

D. None of the above alternatives.

GROUP II

(12 points – 95 minutes)

Attached you'll find the Consolidated Financial Statements of **PRADA SGPS** as of 30 December 2011 and 30 December 2010.

"*For Prada, fashion, luxury and style have always been core aspects of a project that goes beyond production of clothes, footwear and handbags. Careful observation and interest in the world, society, and culture are at the core of Prada's creativity and modernity. This has pushed Prada beyond the physical limitations of boutiques and showrooms, leading us to interact with diverse, seemingly distant worlds, and introducing, very naturally, a new way of creating fashion". Miuccia Prada and Patrizio Bertelli.*

These values have transformed a family business into a major player in the luxury market worldwide.

The PRADA Group is one of the world's leaders in the design, production and distribution of luxury handbags, leather goods, footwear, ready-to-wear apparel, accessories, eyewear and fragrances. The Group owns some of the most prestigious international brands: Prada, Miu Miu, Car Shoe and Church's.

The Group operates in 70 countries through 388 (as of 31 January 2012) directly operated stores, 30 franchise stores and a network of selected high-end multi-brand stores and luxury department stores.

(from Prada's website)

PRADA's annual financial statements are prepared in conformity with the International Financial Reporting Standards (IFRS).

1. **Property, Plant and Equipment** (4 points – 30 minutes)

Note 6. Main accounting policies

Property, plant and equipment are recorded at purchase cost or production cost, including any charges directly attributable. They are shown net of accumulated depreciation calculated on the basis of the useful lives of the assets and any impairment losses. Interest costs on borrowings to finance directly purchase, construction or production are capitalized to increase the value of the asset. All other borrowing costs are charged to the Income Statement.

Note 16: Describe the changes in PPE

Changes in the historical cost of Property, plant and equipment during the year ended January 31, 2012:

(amounts in thousands of Euro)	Land and buildings	Production plant and machinery	Leasehold improvements	Furniture & fittings	Other tangibles	Assets under construction	Total historical cost
Balance at January 31 2011	172,525	97,048	487,208	176,512	84,493	59,157	1,076,943
Additions	40,806	7,030	110,797	29,329	18,825	51,820	258,607
Disposals	-	(300)	(106)	(525)	(1,656)	(15)	(2,602)
Exchange differences	1,968	238	29,531	6,090	944	3,501	42,272
Other movements	288	15	23,893	4,860	1,116	(30,627)	(455)
Impairment	-	(8)	(10,187)	(5,470)	(646)	(1,216)	(17,527)
Balance at January 31 2012	215,587	104,023	641,136	210,796	103,076	82,620	1,357,238

Changes in accumulated depreciation of Property, plant and equipment during the year ended January 31, 2012:

(amounts in thousands of Euro)	Land and buildings	Production plant and machinery	Leasehold improvements	Furniture & fittings	Other tangibles	Total accum. deprec'n
Balance at January 31 2011	26,923	82,006	267,096	104,403	59,798	540,226
Depreciation	5,055	6,635	62,899	18,691	5,850	99,130
Disposals	-	(296)	(45)	(342)	(1,593)	(2,276)
Exchange differences	525	210	14,894	3,685	619	19,933
Other movements	-	-	(118)	975	(975)	(118)
Impairment	-	(8)	(7,914)	(5,000)	(605)	(13,527)
Balance at January 31 2012	32,503	88,547	336,812	122,412	63,094	643,368

a. Explain the meaning and **comment the values** of:
   - Additions
   - Disposals
   - Exchange differences
   - Other movements
   - Impairments

b. Explain why IAS 16 allows the capitalization of financial costs (10 lines).

2. (2 points – 15 minutes)

Note 17, about Intangible Assets, gives the following information about the changes in the net book value of intangibles assets:

(amounts in thousands of Euro)	Trade-marks	Goodwill	Store Lease Acquisitions	Software	Development costs	Assets in progress	Total net book value
Balance at January 31 2011	312,460	503,946	36,087	6,385	7,869	2,372	869,119
Additions	166	-	14,393	4,178	128	1,384	20,249
Amortization	(11,025)	-	(8,354)	(3,067)	(4,726)	-	(27,172)
Disposals	-	-	-	(4)	(1)	-	(5)
Exchange differences	1,707	274	358	16	-	12	2,367
Other movements	-	-	190	1,071	-	(2,278)	(1,017)
Impairment	-	-	-	(1)	-	(14)	(15)
Balance at January 31 2012	303,308	504,220	42,674	8,578	3,270	1,476	863,526

a. Explain which type of Trademarks can be recognised in Prada's Statement of Financial Position. Comment on the measurement criteria of this item, identifying the initial measurement and the alternative post-acquisition criteria. Explain also if it can be depreciated and impaired.

b. Define Goodwill and explain when it can be recognised as an asset.

3. **Operating lease** (5 points – 20 minutes)

Use the information presented in one of the last notes, Note 40, and:

a. Determine Prada's position in this lease contract (lessee or lessor)

b. Analyse, for the most recent year, its impact on the Prada's ratios: total debt ratio, current debt ratio and non-current debt ratio.

40. Commitments

Operating leases

At January 31, 2012 and January 31, 2011, operating lease commitments, by maturity date, were as follows:

(amounts in thousands of Euro)	January 31 2012	January 31 2011
Within a year	245,310	198,481
After between one year and five years	746,902	660,454
After more than five years	596,745	535,779
Total	1,588,957	1,394,714

The following table shows the amounts paid in the financial years 2011 and 2010:

(amounts in thousands of Euro)	January 31 2012	January 31 2011
Fixed minimum lease payments	173,676	154,582
Variable lease payments	187,866	140,472
Total	361,542	295,054

Some Group companies are required to pay lease charges based on a fixed percentage of net sales.

4. **ROE** (5 points – 30 minutes)

   a. Compute, for the most recent year, the several components of Total ROE. Use the following formula:

$$ROE = \left[ROA + (ROA - i) * \frac{Liabilitie}{Equity}\right](1-t)$$

Consider the information on note 36 which allow you to identify Interest expenses:

36. Interest and other financial income / (expenses), net

Interest and other financial income (expenses), net may be analyzed as follows:

(amounts in thousands of Euro)	January 31 2012	January 31 2011
Interests expenses on borrowings	(16,843)	(18,002)
Interest income	2,689	1,306
Exchange gains / (losses) – realized	(1,158)	(5,318)
Exchange gains/ (losses) – unrealized	(6,116)	657
Other financial income / (expenses)	(4,599)	(4,580)
Revaluations (writedown) of investments	-	(4,221)
Total	(26,027)	(30,158)

   b. Explain the meaning of the several components values on the final ROE figures.

   c. How could the answer to question 3 change your ROE component analysis? *Suggestion: Identify which values in the ROE formula would change and its consequent impact. (10 lines)*

GROUP III

(3 points – 20 minutes)

The case "Identifying and Coping with Balance Sheet Differences: A Comparative Analysis of U.S., Chinese and French Oil and Gas Firms Using the Statement of Financial Structure" identifies 6 different types of financial structures of WC/ WCN/ NC.

1. Describe the typical financial structure of a manufacturing firm (10 lines).
2. Describe the typical financial structure of a retail or distribution firm (10 lines).
3. A rather dangerous structure (10 lines).

Consolidated statement of financial position

(amounts in thousands of Euro)	Note	January 31 2012	January 31 2011
Assets			
Current assets			
Cash and cash equivalents	9	362,284	96,572
Trade receivables, net	10	266,404	274,175
Inventories	11	374,782	280,409
Derivative financial instruments - current	12	894	7,379
Receivables and prepayments from parent company - related parties	13	12,864	36,317
Other current assets	14	100,275	70,225
Assets held for sale	15	-	4,948
Total current assets		1,117,503	770,025
Non-current assets			
Property, plant and equipment	16	713,870	536,717
Intangible assets	17	863,526	869,119
Associated undertakings	18	15,631	1,753
Deferred tax assets	37	175,736	141,378
Other non-current assets	19	57,302	44,883
Derivative financial instruments - non current	12	-	2,140
Total non-current assets		1,826,065	1,595,990
Total Assets		2,943,568	2,366,015
Liabilities and Shareholders' equity			
Current liabilities			
Bank overdrafts and short-term loans	20	165,485	194,240
Payables to parent company - related parties	21	4,361	1,148
Other shareholders' loans	22	-	581
Trade payables	23	283,538	233,825
Current tax liabilities	24	117,770	107,592
Derivative financial instruments - current	12	15,200	5,279
Obligations under finance leases - current	25	1,453	5,019
Other current liabilities	26	128,777	111,482
Total current liabilities		716,584	659,166
Non-current liabilities			
Long-term financial payables	27	178,442	303,408
Obligations under finance leases non-current	25	1,100	2,509
Post-employment benefits	28	35,898	34,833
Provision for contingencies and commitments	29	56,921	52,725
Deferred tax liabilities	37	47,665	52,711
Other non-current liabilities	30	75,656	50,207
Derivative financial instruments non-current	12	335	318
Total non-current liabilities		396,017	496,711
Total Liabilities		1,112,601	1,155,877
Share capital		255,882	250,000
Other reserves		1,152,171	743,543
Translation reserve		(17,239)	(40,012)
Net profit for the year		431,929	250,819
Total Shareholders' Equity – Group	31	1,822,743	1,204,350
Shareholders' Equity – Non-controlling interests	32	8,224	5,788
Total Liabilities and Shareholders' Equity		2,943,568	2,366,015
Net current assets		400,919	110,859
Total assets less current liabilities		2,226,984	1,706,849

Consolidated income statement

(amounts in thousands of Euro)	Note	January 31 2012	%	January 31 2011	%
Net revenues	33	2,555,606	100.0%	2,046,651	100.0%
Cost of goods sold	34	(727,581)	-28.5%	(658,763)	-32.2%
Gross margin		1,828,025	71.5%	1,387,888	67.8%
Operating expenses	35	(1,199,090)	-46.9%	(969,501)	-47.4%
EBIT		628,935	24.6%	418,387	20.4%
Interest and other financial income/(expenses), net	36	(26,027)	-1.0%	(30,158)	-1.5%
Income before taxes		602,908	23.6%	388,229	19.0%
Taxation	37	(166,483)	-6.5%	(134,678)	-6.6%
Net income for the year from continuing operations		436,425	17.1%	253,551	12.4%
Net income for the year from discontinued operations		-	-	-	-
Net income for the year		436,425	17.1%	253,551	12.4%
Net income from discontinued operations – non-controlling interests		-	-	-	-
Net income from continuing operations – non-controlling interests	32	4,496	0.2%	2,732	0.1%
Net income – non-controlling interests		4,496	0.2%	2,732	0.1%
Net income from discontinued operations – Group		-	-	-	-
Net income from continuing operations – Group		431,929	16.9%	250,819	12.3%
Net income – Group		431,929	16.9%	250,819	12.3%
Basic and diluted earnings per share (in Euro per share)		0.170		0.100	

DEBT RATIOS/ LONG TERM SOLVENCY RATIO

Debt ratio* = $\frac{\text{Total Liabilities}}{\text{Total Assets}}$

* or Total-Debt-to-Total-Asstes

Shareholders' ratio = $\frac{\text{Shareholders' Equity}}{\text{Total Assets}}$

Solvability ratio = $\frac{\text{Equity}}{\text{Total Liabilities}}$

Current debt ratio = $\frac{\text{Current debt}}{\text{Total Assets}}$

Non-Current debt ratio = $\frac{\text{Non-Current debt}}{\text{Total Assets}}$

Interest-bearing debt ratio = $\frac{\text{Interest-bearing liabilities}}{\text{Total Assets}}$

Non-Interest-bearing debt ratio = $\frac{\text{Non-Interest-bearing liabilities}}{\text{Total Assets}}$

LIQUIDITY RATIO

Current ratio = $\frac{\text{Current assets}}{\text{Current Liabilities}}$

Quick ratio or Acid test ratio = $\frac{\text{Current assets - Inventories}}{\text{Current Liabilities}}$

Cash ratio = $\frac{\text{Cash + Cash equivalents}}{\text{Current Liabilities}}$

Current debt ratio = $\frac{\text{Current debt}}{\text{Total Assets}}$

Average Collection Period (in days) = $\frac{\text{Average Trade Receivables}}{\text{Sales/365}}$

Accounts Receivable Turnover = $\frac{\text{Sales/365}}{\text{Average Trade Receivables}}$

Average Inventory Period (in days) = $\frac{\text{Average Inventory}}{\text{Cost of Goods Sold/365}}$

Inventory Turnover = $\frac{\text{Cost of Goods Sold/365}}{\text{Average Inventory}}$

Average Payment Period (in days) = $\frac{\text{Average Trade Payable}}{\text{Acquisitions/365}}$

Accounts Receivable Turnover = $\frac{\text{Acquisitions/365}}{\text{Average Trade Receivables}}$

PROFITABITITY RATIOS

EBIT margin = $\frac{\text{EBIT}}{\text{Operating Revenues}}$

EBITDA margin = $\frac{\text{EBITDA}}{\text{Operating Revenues}}$

Margin before int. exp. and inc. taxes = $\frac{\text{Income before int. exp. and inc. taxes}}{\text{Operating Revenues}}$

Margin before income tax = $\frac{\text{Income before income tax}}{\text{Operating Revenues}}$

Net profit margin* = $\frac{\text{Net income}}{\text{Operating Revenues}}$

* or Return on sales

MARKET PRICE AND DIVIDEND RATIOS

EPS = $\frac{\text{Net income}}{\text{Average number of shares outstanding}}$

P-E Ratio = $\frac{\text{Market price per share of common stock}}{\text{Earnings per share of common stock}}$

Dividend-Yield Ratio = $\frac{\text{Common dividends per share}}{\text{Current market price of stock}}$

Dividend-Payout Ratio = $\frac{\text{Common dividends per share}}{\text{Earnings per share}}$

ACTIVITY RATIO

Sales to Working Capital ratio = $\frac{\text{Sales}}{\text{Average Working Capital Need}}$

Sales-per-employee ratio = $\frac{\text{Sales}}{\text{Average Number of Employees}}$

Net income-per-employee ratio = $\frac{\text{Net income}}{\text{Average Number of Employees}}$

RETURN ON ASSETS (ROA)

Return on assets = $\frac{\text{Operating income + Financial revenue}}{\text{Total Assets}}$

RETURN ON EQUITY (ROE)

Return on equity = $\frac{\text{Net income}}{\text{Shareholders' Equity}}$

$$ROE = \left[ROA + (ROA - i) * \frac{\text{Liabilities}}{\text{Equity}}\right](1 - t)$$

$$ROE = \frac{\text{Net I.}}{\text{Equity}} = \frac{\text{EBIT} + \text{F.R.}}{\text{Sales}} * \frac{\text{Sales}}{\text{Assets}} * \frac{\text{IBT}}{\text{EBIT} + \text{F.R.}} * \frac{\text{Assets}}{\text{Equity}} * \frac{\text{NetI.}}{\text{IBT}}$$