



EXPRESS Notes

ACCA Paper P2 (INT)

Corporate Reporting

For exams in 2012



theexpgroup.com

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START About Express Notes

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Your stage in study for each paper	These Express notes	EXP recommended course notes, or EXPedite notes	EXP recommended exam kit	ACCA online past exams
Prior to study, e.g. deciding which optional papers to take	Skim through the Express notes to get a feel for what's in the syllabus, the "size" of the paper and how much it appeals to you.	Don't use yet	Don't use yet	Have a quick look at the two most recent real ACCA exam papers to get a feel for examiner's style.
At the start of the learning phase	Work through each chapter of the Express notes in detail before you then work through your course notes. Don't try to feel that you have to understand everything – just get an idea for what you are about to study. Don't make any annotations on the Express notes at this stage.	Work through in detail. Review each chapter after class at least once. Make sure that you understand each area reasonably well, but also make sure that you can recall key definitions, concepts, approaches to exam questions, mnemonics, etc.	Nobody passes an exam by what they have studied – we pass exams by being efficient in being able to prove what we know. In other words, you need to have effectively input the knowledge and be effective in the output of what you know. Exam practice is key to this. Try to do at least one past exam question on the learning phase for each major chapter.	Don't use at this stage.

Your stage in study for each paper	These Express notes	ExP recommended course notes, or ExPeditate notes	ExP recommended exam kit	ACCA online past exams
Practice phase	Work through the Express notes again, this time annotating to explain bits that you think are easy and be brave enough to cross out the bits that you are confident you'll remember without reviewing them.	Avoid reading through your notes again. Try to focus on doing past exam questions first and then go back to your course notes/ Express notes if there's something in an answer that you don't understand.	This is your most important tool at this stage. You should aim to have worked through and understood at least two or three questions on each major area of the syllabus. You pass real exams by passing mock exams. Don't be tempted to fall into "passive" revision at this stage (e.g. reading notes or listening to CDs). Passive revision tends to be a waste of time.	Download the two most recent real exam questions and answers. Read through the technical articles written by the examiner. Read through the two most recent examiner's reports in detail. Read through some other older ones. Try to see if there are any recurring criticisms he or she makes. You must avoid these!
The night before the real exam	Read through the Express notes in full. Highlight the bits that you think are important but you think you are most likely to forget.	Unless there are specific bits that you feel you must revise, avoid looking at your course notes. Give up on any areas that you still don't understand. It's too late now.	Don't touch it!	Do a final review of the two most recent examiner's reports for the paper you will be taking tomorrow.
At the door of the exam room before you go in.	Read quickly through the full set of Express notes, focusing on areas you've highlighted, key workings, approaches to exam questions, etc.	Avoid looking at them in detail, especially if the notes are very big. It will scare you.	Leave at home.	Leave at home.

Our Express notes fit into our portfolio of materials as follows:

Express Notes

Provide a base understanding of the most important areas of the syllabus only.



Expedite Notes

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START
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Chapter 1

Group Accounting



START
The Big Picture

Group accounting will form the backbone of the compulsory question 1 in the exam, and will be worth approximately a third of the marks in the exam.

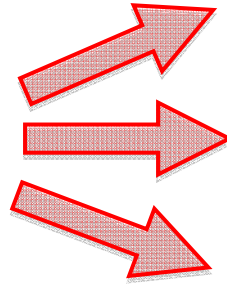
Most people do rather better in the groups part of the exam. Without doubt, groups are important, but be careful not to over-estimate the importance of groups in your preparation. Paper P2 is mostly **not** about group accounting!

Although question 1 will be a groups question at its core, there will be lots of other adjustments in the individual accounts that require correction **before** the consolidation.

These notes focus on the areas of groups that are new to paper P2 from paper F7, though we start with some core definitions and workings that should be familiar from paper F7.

Consolidation is the process of replacing the single figure for “investment in subsidiary” in the individual financial statements of the parent with more useful information about what assets, liabilities, income and expenditure the parent company controls via its investment, ie:

Consideration transferred to buy subsidiary (as shown in the parent company's individual accounts)



Net assets in the subsidiary's financial statements (ie equity or capital plus reserves) at the acquisition date.

Non-controlling interests' share of the net assets of the subsidiary.

Goodwill arising on acquisition (premium paid to acquire the subsidiary).

Consolidation is basically a double entry to derecognise the carrying value of the investment (Cr Investment in subsidiary) and recognise the individual assets (Dr PP&E, etc), the liabilities (Cr Payables, etc), the non-controlling interest (CR NCI) and recognise goodwill as a balancing, residual, item (normally DR Goodwill).



Key definitions What group accounting is trying to do

Subsidiary

Any entity that is controlled by another entity, normally by having more than 50% of the voting power, though there is no minimum shareholding.

Parent

An entity that controls one or more entities.

Associate

A company in which the parent has significant influence, but not control nor joint control (as with a joint venture).

Control

An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Significant influence

The power to control the financial and operating policies of another entity, so as to obtain benefit from its activities.

Equity

Equity is defined in the Framework document as assets less liabilities. By definition, this is the same as capital and reserves of any company at any date in time. In group accounting, we very frequently use the capital + reserves = net assets. For example,

this is used to work out the net assets on the date of acquiring control of a company (as part of the goodwill working) and to work out post-acquisition growth in a subsidiary's assets (ie post-acquisition profit).

Group reserves

The cumulative gains made under the control of the parent. The parent company's reserves, plus the post-acquisition retained gains of all subsidiaries, joint ventures and associates.

Non-controlling interest

Formerly called minority interest. The share of the net assets and gains of a subsidiary that is not owned by the parent.

Goodwill

The premium paid by the parent to acquire its interest in a subsidiary or associate.



Key workings

Hopefully familiar from paper F7, but revise thoroughly

Group retained earnings

This working is a core means of earning good marks in the exam. Produce one column for each company under the parent company's influence. Then work down the rows methodically, perhaps using the mnemonic **TOP TIP PET** to make sure you haven't forgotten anything. If the question has different types of reserves (eg revaluation reserve as well as retained earnings) you will need to do a separate working like the one below for each reserve to be shown in the group SFP.

	Parent	Sub 1	Sub 2	Assoc
	\$'000	\$'000	\$'000	\$'000
T oday	10,000	4,000	3,000	4,500
O missions/ errors to correct in the individual financial statements of each company	400	200	(50)	
P rovision (eg for unrealised profit)	(20)	(50)		-
T ime passage effects (eg write-off of fair value adjustments)		(40)	20	
I mpairments of goodwill (cumulative)	(30)			
Sub-total	10,350	4,110	2,970	4,500
P re-acquisition reserves		<u>(2,000)</u>	<u>(1,800)</u>	<u>(4,200)</u>
P ost-acquisition	10,350	2,110	1,170	300

x E ffective ownership	x 100%	x 60 %	x 40% **	x 40%
	10,350	1,266	468	120
TOTAL	12,204			

** This is not a typo! A subsidiary may still be a subsidiary if an effective ownership of less than 50% still gives the parent control. See multiple groups below.

Non-controlling interests

These show the net assets controlled by the parent and so part of the group, but not actually owned by the parent. There is no need to consider pre- and post-acquisition profits when calculating non-controlling interests in the SOFP.

	Sub 1 \$'000	Sub 2 \$'000
Capital and share premium at SOFP date	800	400
Reserves, as consolidated (see eg above)	4,110	2,970
Fair value adjustments at acquisition	250	(80)
Less: Any items in the individual company's SOFP not recognised in the group SOFP (see below)	(50)	-
Net assets (ie equity) as consolidated in the group SOFP	5,110	3,290
x NCI %	40%	60%
Non-controlling interest	2,044	1,974
Total non-controlling interest	4,018	

Goodwill on a business combination

Fair value of consideration transferred 2,240
Less: Fair value of identifiable net assets acquired, calculated as:

Capital and share premium of target	800
Reserves of target at acquisition date	<u>2,000</u>
Net assets (equity) of target at target's book value	2,800
Fair value adjustments to target's net assets	<u>250</u>

Net assets (equity) of target at fair value	3,050	
X % acquired (60%)		<u>(1,830)</u>
Goodwill arising in books of parent for consolidation		<u>410</u>

Goodwill: gross (“total”) or net (“partial”)?

The standard double entry working above produces a goodwill figures as it relates to the parent’s share. Imagine that the fair value paid for the subsidiary was the fair value for a 60% stake. Then we deduct 60% of the net assets. This logically gives 60% or thereabouts of the total implied goodwill (eg reputation, client list, motivated staff) of the subsidiary.

IFRS 3 allows groups a choice with each acquisition whether to leave goodwill net as above, or gross it up to show the implied total value of goodwill. In order to do the gross up, it is necessary to be given the fair value of the non-controlling interests’ stake in the business at the acquisition date. This would be given in the exam.



EXAMPLE

Non-controlling interest at fair value at acquisition date	1,350
Fair value of consideration transferred for 60% stake	<u>2,240</u>
Implied total value of company	3,590
Less: Fair value of identifiable net assets	<u>(3,050)</u>
Implied total goodwill	540
Partial goodwill automatically recognised (see above)	410
Gross-up required for total goodwill recognition	130

This gross up, if chosen as the accounting policy, would be recognised as:

Dr Goodwill	130	
Cr Non-controlling interests		130

Fair values

When buying a company, its previous owner will only accept the fair value of the company as consideration, or they will not sell!

In order to give a true and fair picture of the actual goodwill purchased, it is therefore necessary to record all the assets and liabilities acquired in the subsidiary at their fair value.

Fair value is defined in IFRS 13 as the price that would be received to sell an asset or paid to transfer liability in an orderly transaction between market participants at measurement date; i.e. it is an exit price or estimated using a valuation technique. A few notable fair value adjustments are:

Consideration paid includes the market value of any shares paid. Any **contingent consideration** is valued **assuming that it will be paid**, even if this is not certain.

Acquisition costs are written off immediately.

Contingent liabilities of the subsidiary will be shown in the individual accounts at zero value (see notes on IAS 37), but their existence would reduce the amount the acquirer is willing to pay. They are therefore revalued as if they were provisions in the fair value exercise.

Changes in group structure

Disposals

The gain or loss on disposal of anything is the increase or decrease in net assets recognised as a result of the transaction.

Proceeds (what is coming into the SOFP in the transaction)	X
Less: Carrying value derecognised (what leaves the SOFP)	<u>(X)</u>
Profit or loss on disposal (the increase or decrease in net assets)	<u>X</u>

The carrying value of a subsidiary in a group SOFP comprises:

- Individual assets and liabilities of the subsidiary at the SOFP date
- Goodwill remaining from the purchase by the parent
- Non-controlling interests at the SOFP date.

Therefore, the gain or loss on derecognition of a subsidiary is:

Proceeds (what is coming into the SOFP in the transaction)	X
Less:	
Individual assets and liabilities of the subsidiary at the SOFP date	(X)

Goodwill remaining from the purchase by the parent	(X)
Non-controlling interests at the SOFP date	<u>(X)</u>
Group gain or loss on disposal	<u>XX</u>

The same working can be used to calculate gain or loss on partial disposal, where non-controlling interest increases (eg where ownership goes from 80% to 60%).

Where a holding goes from 80% to 40%, the calculation is amended slightly, as in addition to sales proceeds for the partial stake, there will also be a new associate recognised.

Proceeds (what is coming into the SOFP in the transaction)	X
Value of new associate recognised	X
Less:	
Individual assets and liabilities of the subsidiary at the SOFP date	(X)
Goodwill remaining from the purchase by the parent	(X)
Non-controlling interests at the SOFP date	<u>(X)</u>
Group gain or loss on disposal	<u>XX</u>

Step acquisitions

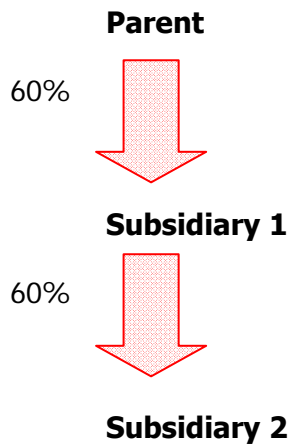
Where an acquisition happens in stages (as it often does in reality), the treatment is to treat the acquisition as a purchase on the date when control happens. Also derecognise any previous holding, which might have been an available-for-sale financial asset or an associate.

This results in an acquisition of a subsidiary and a gain or loss on disposal as part of the same transaction.

In effect, step acquisitions use much the same logic as disposals, but in reverse.

Multiple group structures

You should expect the structure of the group in question 1 in the exam to be a multiple group structure, such as:



The main additional matters to consider here are:

- What is the **nature of the relationship** between parent and subsidiary 2? Even if the effective ownership is less than 50% (as it is here), it may still be a subsidiary, as there is effectively a **chain of command** by which the parent can control subsidiary 2. Parent has control of subsidiary 1, which has control of subsidiary 2.
- In this example, the parent has an effective ownership of 36%, but has control. Subsidiary 2 is therefore consolidated as part of the Parent group, with non-controlling interests of 64%.
- **The dates of acquisition determine whether there is one goodwill calculation, or more.** If Parent acquired Subsidiary 1 on 1.1.x1 and Subsidiary 1 acquired Subsidiary 2 on 1.1.x2, then there would be two transactions under Parent's control, using resources controlled by Parent. This would require two goodwill calculations. However, if Subsidiary 1 had acquired Subsidiary 2 on 1.1.x1 and Parent acquired Subsidiary 1 on 1.1.x2, there would only be one transaction under Parent's control, using Parent's resources. This would give one goodwill calculation
- In the group SOFP, any **historical costs of investments in subsidiaries are not included in the group SOFP**, as the subsidiary's individual assets and liabilities are consolidated instead. This means that any **cost of investment in Subsidiary 2** in the SOFP in Subsidiary 1 are **excluded from** the group SOFP and therefore **NCI calculation**.

- May not be the currency of the country in which the company operates, especially if the company is more like a branch of a foreign parent and depends upon the foreign parent for day-to-day support.
- All other currencies other than the functional currency are a foreign currency.



Key workings/ methods Translation rules

1

Record all transactions in the functional currency. Record all purchases, sales, etc at the spot rate ruling on the date of the translation.

2

At the period end:

Translate monetary assets and liabilities at the closing rate

Don't retranslate non-monetary items

3A

Exchange difference arising in the year on retranslation of foreign currency loans is reported in profit in finance income/ finance cost.

3B

Exchange difference arising in the year on retranslation of foreign currency trade payables and receivables is reported in profit in other operating income/ other operating expenses.



Key workings/ methods Presentation rules

This is normally examined in the context of group accounting, but it could be examined as a single company only.

An entity may choose any currency it likes for the presentation of its financial statements. Eg a company with a dual listing in the USA and in the European Union is likely to choose the US dollar as its presentation currency and also the euro as its presentation currency.

The basic rules are simple: translate the financial statements using these rules:

- All items in the SOFP: translate at the closing rate.
- All items in the SOCI: translate at the average rate for the period, or spot rate for any large one-off items.

Exchange differences will arise, eg imagine the position of Lear Co for the year ended 31 Dec 20x1:

Date	Euro
Net assets (equity) at 1 Jan 20x1	10,000
Profit for the year to 31 Dec 20x1	2,000
Other comprehensive income for the year to 31 Dec 20x1	1,000
Dividend declared for the year	<u>(1,500)</u>
Net assets (equity) at 31 Dec 20x1	<u>11,500</u>

Assume these exchange rates USD/ EUR

1 Jan 20x1	1.2
Average for 20x1	1.25
31 Dec 20x1	1.15

Date	Euro	Exchange rate	USD
Net assets (equity) at 1 Jan 20x1	10,000	1.2	12,000
Profit for the year to 31 Dec 20x1	2,000	1.25	2,500
Other comprehensive income for the year to 31 Dec 20x1	1,000	1.25	1,250
Dividend declared for the year	<u>(1,500)</u>	1.15	<u>(1,725)</u>
Net assets (equity) at 31 Dec 20x1	<u>11,500</u>	1.15	<u>13,225</u>

This does not add up!

The error is an **exchange difference arising in the year**.

This is not considered to be a realised gain or loss, so is reported directly in equity in the statement of changes in equity. It is not reported as part of other comprehensive income.

So Lear Co's statement of changes in equity for the year ended 31 Dec 20x1 will show:

Date	USD	
Net assets (equity) at 1 Jan 20x1	12,000	This exchange gain or loss arising on translation in the year is a gain in the reserves of the subsidiary for consolidation. It is therefore split between parent and non-controlling interests.
Profit for the year to 31 Dec 20x1	2,500	
Other comprehensive income for the year to 31 Dec 20x1	1,250	
Dividend declared for the year	(1,725)	
Exchange gain on translation arising in the year (balancing item)	<u>800</u>	
Net assets (equity) at 31 Dec 20x1	<u>13,225</u>	

Groups and foreign currency

It is common to have to translate the financial statements of a subsidiary into the reporting currency of the parent **prior to consolidation**.

This is simply an additional stage to complete prior to the process of consolidation.

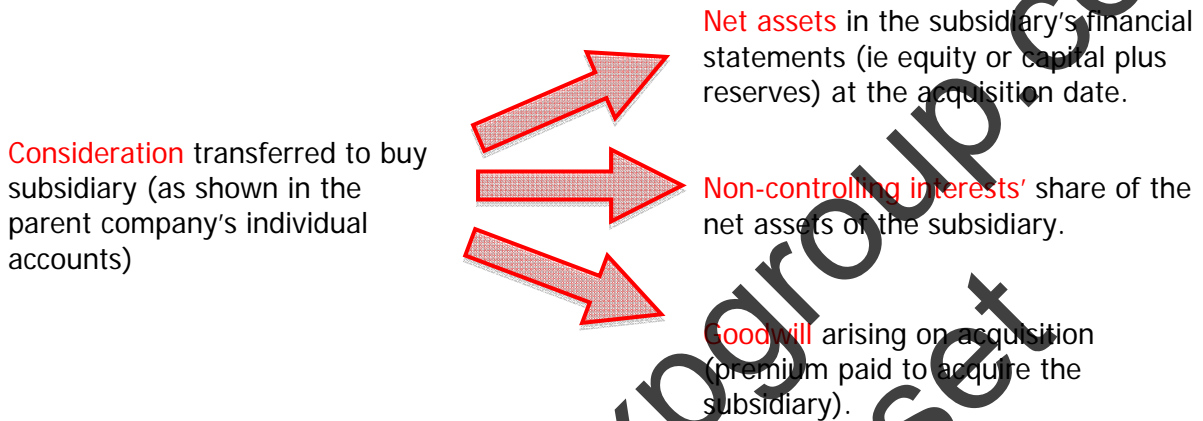
Approach to questions with foreign subsidiaries:

- 1** Correct the individual accounts of each company for errors/ omissions in the individual accounts.
- 2** Translate the subsidiary's financial statements into the presentation currency of the parent using the **presentation rules**.
- 3** **Consolidate** as normal.

Further aspects of foreign currency groups

Goodwill

Goodwill on consolidation always arises in the books of the acquirer (ie parent) since it is the property of the parent company. The cost of buying the subsidiary from its previous owners can be broken down into:



The goodwill's value will vary with the exchange rate as the value of the subsidiary's future earnings in the parent's currency will vary with the exchange rate. This means that goodwill must be revalued each year with a consequent revaluation gain or loss.

This means that each year, goodwill must be calculated similarly to how the exchange gain or loss is calculated for the translation of the net assets of the subsidiary:

Date	Euro	Exchange rate	USD
Goodwill at 1 Jan 20x1	1,000	1.2	1,200
Impairment loss in the year to 31 Dec 20x1	(200)	1.25	(250)
Exchange difference in the year	-	balance	<u>50</u>
Goodwill at 31 Dec 20x1	<u>800</u>	1.25	<u>1,000</u>

This gain of 50 is a gain made by the parent, so part of the parent's reserves



Key workings/ methods

Translation of subsidiary's financial statements for consolidation

Statement of financial position of subsidiary at the year-end	Foreign currency (€)	Exchange rate	Presentation currency (\$)
Assets (top half of SOFP)	€X	Year end rate	\$X
Capital of subsidiary	€X	Rate at acquisition	\$X
Reserves of subsidiary @ acquisition	€X	Rate at acquisition	\$X
Post acquisition gains (balancing item)	€X	balance	\$X
Liabilities	€X	Year-end rate	\$X
Total equity and liabilities	€X		\$X

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