CHAPTER 9

Annual Report: additional financial statements

9.1 Introduction

The main purpose of this chapter is to explain the additional content in an Annual Report that assists users to make informed estimates of future financial performance.

Objectives

By the end of this chapter, you should be able to:

- discuss the value segmental information adds to published financial statements;
- understand and evaluate the structure and content of Segmental Reports and discuss the major provisions of IFRS 8 *Operating Segments*;
- explain the criteria laid out in IFRS 5 *Non-current assets held for sale and discontinued operations* that need to be satisfied before an asset (or disposal group) is classified as 'held for sale';
- explain the accounting significance of classifying an asset or disposal group as 'held for sale';
- explain the meaning of the term 'discontinued operations' and discuss the impact of such operations on the statement of comprehensive income;
- understand the effect on financial statements of events occurring after the end of the reporting period in accordance with IAS 10;
- identify Related Parties in accordance with IAS 24 (revised November 2009).

9.2 The value added by segment reports

In this section we review the reasons for and importance of segment reporting in the analysis of financial statements. We will also summarise the progress to date in developing an internationally accepted financial reporting standard on this subject.

9.2.1 The benefits of segment reporting

The majority of listed and other large entities derive their revenues and profits from a number of sources (or segments). This has implications for the investment strategy of the entity as different segments require different amounts of investment to support their activities. Conventionally produced statements of financial position and statements of comprehensive income capture financial position and financial performance in a single column of figures.

Segment reports provide a more detailed breakdown of key numbers from the financial statements. Such a breakdown potentially allows a user to:

- appreciate more thoroughly the results and financial position by permitting a better understanding of past performance and thus a better assessment of future prospects;
- be aware of the impact that changes in significant components of a business may have on the business as a whole;
- be more aware of the balance between the different operations and thus able to assess the quality of the entity's reported earnings, the specific risks to which the company is subject, and the areas where long-term growth may be expected.

9.2.2 Constraints on comparison between entities

Segment reporting is intrinsically subjective. This means that there are likely to be major differences in the way segments are determined, and because costs, for instance, may be allocated differently by entities in the same industry it is difficult to make inter-entity comparisons at the segment level and the user still has to take a great deal of responsibility for the interpretation of that information.

9.2.3 Progress in developing an internationally agreed standard on segment reporting

A number of domestic standard setters have developed a standard on this subject. For example, in the UK, SSAP 25 *Segmental Reporting*, was issued in June 1990 with a scope that included listed and very large entities. Its objective was to assist users in evaluating the different business segments and geographical regions of a group and how they would affect its overall results. This particular standard is of questionable benefit as it contained a 'get-out' clause that allowed entities not to give the required disclosures if the directors believed that to do so would be 'seriously prejudicial' to the reporting entity.

In 1997 the predecessor body to the IASB issued IAS 14 – *Segment reporting*. IAS 14 applied to listed entities only and required such entities to identify reportable segments based on geographical and 'type of business' grounds. One or other of the segment types had to be designated the primary reportable segments whilst the other type was to be the secondary reportable segments. The disclosures that had to be given were prescriptive and, at least in theory, consistent across entities.

The issue of segment reporting has been one that was on the agenda of the convergence project between the IASB and the FASB (the primary setter of standards in the United States of America). IFRS 8 *Operating segments* was issued in November 2006 following joint consultation between the two bodies.

9.3 Detailed review and evaluation of IRFS 8 – *Operating Segments*[1]

9.3.1 Overview and scope

The IASB published IFRS 8 *Operating Segments* in November 2006 as part of the IASB convergence project with US GAAP. IFRS 8 replaces IAS 14 and aligns the international rules with the requirements of SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*. Once adopted, IFRS and US GAAP will be the same, except for some very minor differences.

The scope of IFRS 8 remains the same as IAS 14. It applies to separate or individual financial statements of an entity (and to consolidated financial statements of a group with a parent):

- whose debt or equity instruments are traded in a public market; or
- that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in the public market.

If an entity not within the scope of IFRS 8 chooses to prepare information about segments that does not comply with IFRS 8, it should not be described as segment information.

9.3.2 Effective date

IFRS 8 is mandatory for periods beginning on or after 1 January 2009, but earlier adoption is allowed. However, EU companies could not adopt IFRS 8 until it was endorsed by the EU. This endorsement took place in late 2007. When the new standard is adopted, the comparatives need to be restated, unless the cost would be excessive.

9.3.3 Key changes from IAS 14

IFRS 8 adopts the management approach to segment reporting and the disclosure of information used to manage the business rather than the strict rule based IAS 14 disclosures.

The three key areas of difference between IFRS 8 and IAS 14 are:

- identification of segments;
- measurement of segment information; and
- disclosures.

9.3.4 Identification of segments

IFRS 8 requires the identification of operating segments on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker (CODM) in order to allocate resources to the segment and assess its performance. Under IFRS 8 there will be a single set of operating segments rather than the primary and secondary segments of IAS 14.

Also, per IFRS 8 a segment that sells exclusively or mainly to other operating segments of the group meets the definition of an operating segment if the business is managed in that way. IAS 14 limited reportable segments to those that earn a majority of revenue from external customers.

Criteria for identifying a segment

An operating segment is a component of an entity:

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to other components of the same entity);

(b) whose operating results are regularly reviewed by the entity's chief operating decision maker, to make decisions about resources to be allocated to the segment and to assess its performance; and

(c) for which discrete financial information is available.

Not every part of the entity will necessarily be an operating segment. For example, a corporate headquarters may not earn revenues.

Criteria for identifying the chief operating decision maker

The 'chief operating decision maker' may be an individual or a group of directors or others. The key identifying factors will be those of performance assessment and resource allocation. Some organisations may have overlapping sets of components for which managers are responsible, e.g. some managers may be responsible for specific geographic areas and others for products worldwide. If the CODM reviews the operating results of both sets of components, the entity shall determine which constitutes the operating segments using the core principles (a)–(c) above.

9.3.5 Identifying *reportable* segments

Once an operating segment has been identified, a decision has to be made as to whether it has to be reported. The segment information is required to be reported for any operating segment that meets any of the following criteria:

(a) its reported revenue, from internal and external customers, is 10% or more of the combined revenue (internal and external) of all operating segments; or

(b) the absolute measure of its reported profit or loss is 10% or more of the greater, in absolute amount of (i) the combined profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss; or

(c) its assets are 10% or more of the combined assets of all operating segments.

Failure to meet any of the criteria does not, however, preclude a company from reporting a segment's results. Operating segments that do not meet any of the criteria may be disclosed, if management think the information would be useful to users of the financial statements.

The 75% test

If the total external revenue of the reportable operating segments is less than 75% of the entity's revenue, additional operating segments should be identified as reportable segments (even if they don't meet the criteria in (a)–(c) above) until 75% of the entity's revenue is included.

Combining segments

Like IAS 14, IFRS 8 includes detailed guidance on which operating segments may be combined to create a reportable segment, e.g. if they have mainly similar products, processes, customers, distribution methods and regulatory environments.

Although IFRS 8 does not specify a maximum number of segments, it suggests that if the reportable segments exceed 10, the entity should consider whether a practical limit had been reached, as the disclosures may become too detailed.

EXAMPLE ● Varia plc is a large training and media entity with an important international component. It operates a state-of-the-art management information system which provides its directors with the information they require to plan and control the various businesses. The directors' reporting requirements are quite detailed and information is collected about the following divisions: Exam-based Training, E-Learning, Corporate Training, Print Media, Online Publishing and Cable Television. The following information is available for the year ended 31 December 2009:

Division	*Total Revenue*	*Profit*	*Assets*
	£m	*£m*	*£m*
Exam-based Training	360	21	176
E-Learning	60	3	13
Corporate Training	125	5	84
Print Media	232	27	102
Online Publishing	124	2	31
Cable TV	73	5	39
	974	63	445

Which of Varia plc's divisions are reportable segments in accordance with IFRS 8 Operating Segments?

Solution

- The revenues of **Exam-based Training**, **Corporate Training**, **Print Media** and **Online Publishing** are clearly more than 10% of total revenues and so these segments are reportable.
- All three numbers for **E-Learning and Cable TV** are under 10% of entity totals for revenue, profit and assets and so, unless these segments can validly be combined with others for reporting purposes, they are not reportable separately, although Varia could choose to provide separate information.

As a final check we need to establish that the combined revenues of reportable segments we have identified (£360 million + £125 million + £232 million + £124 million = £841 million) is at least 75% of the total revenues of Varia of £974 million. £841 million is 86% of £974 million so this condition is satisfied. Therefore no other segments need to be added.

9.3.6 Measuring segment information

IFRS 8 specifies that the amount reported for each segment should be the measures reported to the chief operating decision maker for the purposes of allocating resources and assessing performance. IAS 14 required the information to be measured in accordance with the accounting policies adopted for presenting and preparing information in the consolidated accounts.

IAS 14 defined segment revenue, segment expense, segment result, segment assets, and segments liabilities. IFRS 8 does not define these terms, but requires an explanation of how segment profit or loss and segment assets and segment liabilities are measured for each reportable segment.

Allocations and adjustments to revenues and profit should only be included in segment disclosures if they are reviewed by the CODM.

9.3.7 Disclosure requirements for reportable segments

The principle in IFRS 8 is that an entity should disclose 'information to enable users to evaluate the nature and financial effect of the business activities in which it engages and the economic environment in which it operates'.

IFRS 8 requires disclosure of the following segment information:

(i) Factors used to identify the entity's operating segments, including the basis of organisation (for example, whether management organises the entity around products and services, geographical areas, regulatory environments, or a combination of factors and whether segments have been aggregated).

(ii) Types of products and services from which each reportable segment derives its revenues.

(iii) A measure of profit or loss and total assets for each reportable segment.

(iv) A measure of liabilities for each reportable segment if it is regularly provided to the chief operating decision maker.

(v) The following items **if** they are disclosed in the performance statement reviewed by the chief operating decision maker:

- revenues from external customers;
- revenues from transactions with other operating segments;
- interest revenue;
- interest expense;
- depreciation and amortisation;
- 'exceptional' items;
- interests in profits and losses of associates and JVs (under equity method);
- income tax income or expense;
- other material non-cash items.

(vi) The following items **if** they are regularly provided to the chief operating decision maker:

- the amount of investment in associates and JVs accounted for by the equity method;
- total amounts for additions to non-current assets other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts.

(vii) Reconciliations of profit or loss and assets to the group totals for the entity.

9.3.8 Entity wide disclosures

IFRS 8 requires the following entity wide disclosures, even for those with a single reportable segment:

(i) Revenue from external customers for each product or service, or groups of similar products or services.

(ii) Revenues from external customers (a) attributed to the entity's country of domicile and (b) attributed to all foreign countries in total. If revenues from external customers from an individual country are material, they should be disclosed separately.

(iii) Non-current assets (other than financial instruments, deferred tax assets, post-employment benefits assets and rights under insurance contracts) located in (a) the entity's country of domicile and (b) all other foreign countries. If assets in individual foreign countries are material, they should be disclosed separately.

(iv) The information in (i)–(iii) above should be based on the financial information that is used to produce the entity's financial statements.

(v) Reliance on major customers. If revenues from a single external customer are 10% or more of the entity's total revenue, it must disclose that fact and the segment reporting the revenue. It need not disclose the identity of the major customer or the amount of the revenue.

A 'single customer' is deemed to be entities under common control and a government (national, state, local) and entities known to be under the control of that government shall be considered to be a single customer.

These disclosures are not required if the information is not available and if the costs to develop it would be excessive, in which case this fact should be disclosed. These entity wide disclosures are also not needed if they have already been given under the reportable segment information described in 9.3.7 above.

9.3.9 Evaluation of the impact of IFRS 8

IFRS 8 was developed in part to converge with US practice but also because there was a boilerplate feel to IAS 14 which meant that it was presented by management to accommodate IAS 14 requirements whilst not being seen as important information for management. Some commentators have suggested that the disclosures under IFRS 8 may be more meaningful, as it will be information which the management believe to be important in running the business.

Companies will produce a single set of segmental information for internal and external purposes, which may reduce costs. This does not necessarily mean less information will be disclosed – in fact it may be more, depending on the information that is reviewed by the chief operating decision maker.

Although there may be little impact on the way some entities report segment information, for others it will involve very significant changes to the way they identify reportable segments and disclose segment information. There may be greater diversity in reporting, for example, some companies may report a combination of business and geographic segments, others may identify a single set of segments, say the different business segments.

IFRS 8 requires a much greater disclosure of information than IAS 14. In particular, separate disclosure of both segment assets and segment liabilities are required and the basis of inter-segment pricing. In addition, the information disclosed, for some entities, may be very different from under IAS 14 and the reconciliations to the financial statements may be difficult to understand. How this is to be presented to external users of the accounts should be considered. It is important that investors and analysts know what to expect and what the new disclosures mean.

Continuing concerns following the issue of IAS 8

Despite the existence of IFRS 8, there are many concerns about the extent of segmental disclosure and its limitations must be recognised. A great deal of discretion is imparted to the directors concerning the **definition of each segment**. However, 'the factors which provide guidance in determining an industry segment are often the factors which lead a company's management to organise its enterprise into divisions, branches or subsidiaries'. There is discretion concerning the **allocation of common costs** to segments on a reasonable basis. There is flexibility in the **definition of some of the items** to be disclosed (particularly net assets).

These concerns have been recognised at government level and will be held under review as, for example, by the European Parliament.

European Parliament reservations

In November 2007 the European Parliament accepted the Commission's proposal to endorse IFRS 8, incorporating US Statement of Financial Accounting Standard No. 131

into EU law, which will require EU companies listed in the European Union to disclose segmental information in accordance with the 'through-the-eyes-of-management' approach.

However, it regretted[2] that the impact assessment carried out by the Commission did not sufficiently take into account the interests of users as well as the needs of small and medium-sized companies located in more than one Member State and companies operating only locally. Its view was that such impact assessments must incorporate quantitative information and reflect a balancing of interests among stakeholders. It did not accept that the convergence of accounting rules was a one-sided process where one party (the IASB) simply copies the financial reporting standards of the other party (the FASB). In particular it expressed reservations that disclosure of geographical information on the basis of IFRS 8 would be comparable to that disclosed under IAS 14. It took a strong line by requiring the Commission to follow closely the application of IFRS 8 and to report back to Parliament no later than 2011, *inter alia*, regarding reporting of geographical segments, segment profit or loss, and the use of non-IFRS measures. This underlines that if the Commission discovers deficiencies in the application of IFRS 8 it has a duty to rectify such deficiencies.

Given the global nature of multinationals' activities, the pressure for country-by-country disclosures seems well based and of interest to investors.

UK reservations

The FRRP reviewed a sample of 2009 interim accounts and 2008 annual accounts. On the basis of this review, the FRRP has highlighted situations where companies were asked to provide additional information:

- Only one operating segment is reported, but the group appears to be diverse with different businesses or with significant operations in different countries.
- The operating analysis set out in the narrative report differs from the operating segments in the financial report.
- The titles and responsibilities of the directors or executive management team imply an organisational structure which is not reflected in the operating segments.
- The commentary in the narrative report focuses on non-IFRS measures whereas the segmental disclosures are based on IFRS amounts.

It also suggested a number of questions that directors should ask themselves when preparing segmental reports such as:

- What are the key operating decisions made in running the business?
- Who makes the key operating decisions?
- Who are the segment managers and who do they report to?
- How are the group's activities reported in the information used by management?
- Have the reported segment amounts been reconciled to the IFRS aggregate amounts?
- Do the reported segments appear consistent with their internal reporting?

9.3.10 Sample disclosures under IFRS 8

1 Format for disclosure of segment profits or loss, assets and liabilities

	Hotels	*Software*	*Finance*	*Other*	*Totals*
	£m	*£m*	*£m*	*£m*	*£m*
Revenue from external customers	800	2,150	500	100(a)	3,550
Intersegment revenue	—	450	—	—	450
Interest revenue	125	250	—	—	375
Interest expense	95	180	—	—	275
Net interest revenue (b)	—	—	100	—	100
Depreciation & amortisation	30	155	110	—	295
Reportable segment profit	27	320	50	10	407
Other material non-cash items – impairment of assets	20	—	—	—	20
Reportable segment assets	700	1,500	5,700	200	8,100
Expenditure for reportable segment non-current assets	100	130	60	—	290
Reportable segment liabilities	405	980	3,000	—	4,385

(a) Revenue from segments below the quantitative thresholds are attributed to four operating divisions. Those segments include a small electronics company, a warehouse leasing company, a retailer and an undertakers. None of these segments has ever met any of the quantitative thresholds for determining reportable segments.

(b) The finance segment derives most of its revenue from interest. Management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, as permitted by paragraph 23, only net interest is disclosed.

2 Reconciliations of reportable segment revenues and assets

Reconciliations are required for every material item disclosed, the following are just sample reconciliations.

Revenues	*£m*
Total revenues for reportable segments	3,900
Other revenues	100
Elimination of intersegment revenues	(450)
Entity's revenue	3,550

Profit or loss	*£m*
Total profit or loss for reportable segments	397
Other profit or loss	10
Elimination of inter-segment profits	(50)
Unallocated amounts:	
Litigation settlement received	50
Other corporate expenses	(75)
Adjustment to pension expense in consolidation	(25)
Income before tax expense	307

Assets	*£m*
Total assets for reportable segments	7,900
Other assets	200
Elimination of receivables from corporate headquarters	(100)
Other unallocated amounts	150
Entity's assets	8,150

3 Information about major customers

Sample disclosure might be:

> Revenues from one customer of the software and hotels segments represent approximately £400 million of the entity's total revenue.

(NB: disclosure is not required of the customer's name or of the revenue for each operating segment.)

9.4 IFRS 5 – meaning of 'held for sale'

IFRS 5 *Non-current assets held for sale and discontinued operations*[3] deals, as its name suggests, with two separate but related issues. The first is the appropriate reporting of an asset (or group of assets – referred to in IFRS 5 as a 'disposal group') that management has decided to dispose of.

IFRS 5 states that an asset (or disposal group) is classified as 'held for sale' if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. It further provides that the asset or disposal group must be available for immediate sale in its present condition and its sale must be **highly probable**. For the sale to be highly probable IFRS 5 requires that:

- The appropriate level of management must be committed to a plan to sell the asset or disposal group.
- An active programme to locate a buyer and complete the plan must have been initiated.
- The asset or disposal group must be actively marketed for sale at a price that is reasonable in relation to its current fair value.
- The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.
- Actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

There is a pragmatic recognition that there may be events outside the control of the enterprise which prevent completion within one year. In such a case the held for sale classification is retained, provided there is sufficient evidence that the entity remains committed to its plan to sell the asset or disposal group and has taken all reasonable steps to resolve the delay.

It is important to note that IFRS 5 specifies that this classification is appropriate for assets (or disposal groups) that are to be **sold**. The classification does not apply to assets or disposal groups that are to be **abandoned**.

9.5 IFRS 5 – implications of classification as held for sale

Assets, or disposal groups, that are classified as held for sale should be removed from their previous position in the statement of financial position and shown under a single 'held for sale' caption – usually as part of **current** assets. Any liabilities directly associated with disposal groups that are classified as held for sale should be separately presented within liabilities.

As far as disposal groups are concerned, it is acceptable to present totals on the face of the statement of financial position, with a more detailed breakdown in the notes. The following is a note disclosure from the published financial statements of Unilever for the year ended 31 December 2009:

Assets classified as held for sale

	2009	*2008*
	£m	*£m*
Disposal groups held for sale		
Property, plant and equipment	**7**	7
Inventories	**1**	15
	8	22
Non-current assets held for sale		
Property, plant and equipment	**9**	14
	17	36

Depreciable assets that are classified as 'held for sale' should not be depreciated from classification date, as the classification implies that the intention of management is primarily to recover value from such assets through sale, rather than through continued use.

When assets (or disposal groups) are classified as held for sale their carrying value(s) at the date of classification should be compared with the 'fair value less costs to sell' of the asset (or disposal group). If the carrying value exceeds fair value less costs to sell then the excess should be treated as an impairment loss. In the case of a disposal group, the impairment loss should be allocated to the specific assets in the order specified in IAS 36 – *Impairment*.

9.6 Meaning and significance of 'discontinued operations'

9.6.1 Meaning

IFRS 5 defines a discontinued operation as a component of an entity that, during the reporting period, either:

- has been disposed of (whether by sale or abandonment); or
- has been classified as held for sale, and ALSO
  - represents a separate major line of business or geographical area of operations; or
  - is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
  - is a subsidiary acquired exclusively with a view to resale (probably as part of the acquisition of an existing group with a subsidiary that does not fit into the long term plans of the acquirer).

The IFRS defines a component as one which comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. This definition is somewhat subjective and the IASB is considering amending this definition to align it with that of an operating segment in IFRS 8 (see section 9.3.4 above).

9.6.2 Significance

The basic significance is that the results of discontinued operations should be separately disclosed from those of other, continuing, operations in the statement of comprehensive income. As a minimum, on the face of the statement, entities should show, as a single amount, the total of:

- the post-tax profit or loss of discontinued operations; and
- the post-tax gain or loss recognised on the measurement to fair value less cost to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

Further analysis of this amount is required, either on the face of the statement of comprehensive income or in the notes into:

- the revenue, expenses and pre-tax profit or loss of discontinued operations;
- the related income tax expense as required by IAS 12;
- the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and
- the related income tax expense as required by IAS 12.

The net cash flows attributable to the operating, investing and financing activities of discontinued operations also need to be disclosed separately. As for the disclosures mentioned above for the statement of comprehensive income, these can also either be made on the face of the statement of cash flows or in the notes.

Where an operation meets the criteria for classification as discontinued in the current period, then the comparatives should be amended to show the results of the operation as discontinued even though, in the previous period, the operation did not meet the relevant criteria.

An example of the required disclosures is given below – these relate to Vodafone.

Disposals and discontinued operations

India – Bharti Airtel Limited

On 9 May 2007 and in conjunction with the acquisition of Vodafone Essar, the Group entered into a share sale and purchase agreement in which a Bharti group company irrevocably agreed to purchase the Group's 5.60% direct shareholding in Bharti Airtel Limited. During the year ended 31 March 2008, the Group received £654 million in cash consideration for 4.99% of such shareholding and recognised a net gain on disposal of £250 million, reported in non-operating income and expense. The Group's remaining 0.61% direct shareholding was transferred in April 2008 for cash consideration of £87 million.

Japan – Vodafone K.K.

On 17 March 2006, the Group announced an agreement to sell its 97.7% holding in Vodafone K.K. to SoftBank. The transaction completed on 27 April 2006, with the Group receiving cash of approximately ¥1.42 trillion (£6.9 billion), including the repayment of intercompany debt of ¥0.16 trillion (£0.8 billion). In addition, the Group received non-cash consideration with a fair value of approximately ¥0.23 trillion (£1.1 billion), comprised of preferred equity and a subordinated loan. SoftBank also assumed debt of approximately ¥0.13 trillion (£0.6 billion). Vodafone K.K. represented a separate geographical area of operation and, on this basis, Vodafone K.K. was treated as a discontinued operation in Vodafone Group Plc's annual report for the year ended 31 March 2006.

Income statement and segment analysis of discontinued operations

	2007	*2006*
	£m	*£m*
Segment revenue	**520**	**7,268**
Inter-segment revenue	—	(2)
Net revenue	**520**	**7,266**
Operating expenses	(402)	(5,667)
Depreciation and amortisation(1)	—	(1,144)
Impairment loss	—	(4,900)
Operating profit/(loss)	**118**	**(4,445)**
Net financing costs	8	(3)
	2007	*2006*
	£m	*£m*
Profit/(loss) before taxation	**126**	**(4,448)**
Taxation relating to performance of discontinued operations	(15)	7
Loss on disposal(2)	(747)	—
Taxation relating to the classification of the discontinued operations	145	(147)
Loss for the financial year from discontinued operations(3)	**(491)**	**(4,588)**

(NB: The single amounts shown above were the numbers that were presented in the consolidated income statement.)

Notes:

(1) Including gains and losses on disposal of fixed assets.

(2) Includes £794 million of foreign exchange differences transferred to the income statement on disposal.

(3) Amount attributable to equity shareholders for the year to 31 March 2008 was nil (2007: £(494) million; 2006: £(4,598) million).

Loss per share from discontinued operations

	2007	*2006*
	Pence per share	*Pence per share*
Basic loss per share	(0.90)	(7.35)
Diluted loss per share	(0.90)	(7.35)

Cash flows from discontinued operations

	2007	*2006*
	£m	*£m*
Net cash flows from operating activities	135	1,651
Net cash flows from investing activities	(266)	(939)
Net cash flows from financing activities	(29)	(536)
Net cash flows	**(160)**	**176**
Cash and cash equivalents at the beginning of the financial year	161	4
Exchange loss on cash and cash equivalents	(1)	(19)
Cash and cash equivalents at the end of the financial year	**—**	**161**

9.7 IAS 10 – events after the reporting period[4]

IAS 10 requires preparers of financial statements to evaluate events that occur after the reporting date but before the financial statements are authorised for issue by the directors.

Events in this period are referred to as 'Events after the Reporting Period'. In certain circumstances the financial statements should be adjusted to reflect the occurrence of such events.

9.7.1 Adjusting events

These are events after the reporting period that provide additional evidence of conditions that exist at the year end date. Examples of such events include, but are not limited to:

- After date sales of inventory that provide additional evidence of the net realisable value of the inventory at the reporting date.
- Evidence received after the year end that provides additional evidence of the appropriate measurement of a liability that existed at the reporting date.
- The revaluation of an asset such as a property that indicates the likelihood of impairment **at the reporting date**.

As you might expect, IAS 10 requires that the occurrence of adjusting events should lead to the financial statements themselves being adjusted.

9.7.2 Non-adjusting events

These are events occurring after the reporting period that concern conditions that did not exist at the statement of financial position date. Examples would include:

- an issue shares after the reporting date;
- acquisition of new businesses after the reporting date;
- the loss or other decline in value of assets due to events occurring after the end of the reporting period.

IAS 10 states that the financial statements should not be adjusted upon the occurrence of non-adjusting events. However where non-adjusting events are material, IAS 10 requires disclosure of:

- the nature of the event; and
- an estimate of the financial effect, or a statement that such an estimate cannot be made.

The following is an extract from the 2003 Annual Report of Manchester United:

> **Events after the reporting period**
> After the reporting date, the playing registrations of two footballers have been acquired for a total consideration including associated costs of £18,063,000 of which £7,393,000 is due for payment after more than one year.

9.7.3 Dividends

IAS 10 states that dividends declared after the reporting period are not to be treated as liabilities in the financial statements. A dividend is 'declared' when its payment is no longer at the discretion of the reporting entity. For interim dividends, this does not usually occur until the dividend is actually paid. For final dividends this usually occurs when the shareholders approve the dividend at a general meeting to approve the financial statements, which cannot take place until the financial statements have been prepared! Therefore, the concept of a 'dividend liability' for equity shares has effectively disappeared.

9.7.4 Going concern issues

Deterioration in the operating results or other major losses that occur after the period end are basically non-adjusting events. However, if they are of such significance as to affect the going concern basis of preparation of the financial statements then this impacts on the numbers in the financial statements because the going concern assumption would no longer be appropriate. In this limited set of circumstances an event that would normally be non-adjusting is effectively treated as adjusting.

9.8 Related party disclosures

The users of financial statements would normally assume that the transactions of an entity have been carried out at arms length and under terms which are in the best interests of the entity. The existence of related party relationships **may** mean that this assumption is not appropriate. The purpose of IAS 24 is to define the meaning of the term 'related party' and prescribe the disclosures that are appropriate for transactions with related parties (and in some cases for their mere existence). From the outset it is worth remembering that the term 'party' could refer to an individual **or** to another entity.

9.8.1 Definition of 'related party' – a person

IAS 24 *Related party disclosures*[5] breaks the definition down into two main sections: A person, or a close member of that person's family (P) is a related party to the reporting entity (E) if:

- P has control or joint control over E.
- P has significant influence over E.
- P is a member of the key management personnel of E.

Close members of the family of P are those family members who may be expected to influence, or be influenced by, P in their dealings with E and include:

- P's children and spouse or domestic partner; and
- children of the spouse or domestic partner; and
- dependants of P or P's spouse or domestic partner.

Key management personnel of E are those persons having authority and responsibility for planning, directing and controlling the activities of E, directly or indirectly including any director (whether executive or otherwise) of E.

9.8.2 Definition of related party – another entity

Another entity (AE) is related to E if:

- E and AE are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
- AE is an associate or joint venture of E (or of a group of which E is a member), or vice versa.
- E and AE are both joint ventures of the same third party.

- E is the joint venture of a third entity and AE is an associate of the third entity, or vice versa.
- AE is a post-employment benefit plan for the benefit of either E or an entity related to E. If E is such a plan, then the sponsoring employees are also related to E.
- AE is controlled or jointly controlled by any person that is a related party of E (see 9.8.1 above).

9.8.3 Parties deemed not to be related parties

IAS 24 emphasises that it is necessary to carefully consider the substance of each relationship to see whether or not a related party relationship exists. However, the standard highlights a number of relationships that would not normally lead to related party status:

- two entities simply because they have a director or other member of the key management personnel in common or because a member of the key management personnel of one entity has significant influence over the other entity;
- two venturers simply because they share control over a joint venture;
- providers of finance, trade unions, public utilities or government departments in the course of their normal dealings with the entity;
- a single customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence.

9.8.4 Disclosure of controlling relationships

IAS 24 requires that relationships between a parent and its subsidiaries be disclosed irrespective of whether there have been transactions between them. Where the entity is controlled, it should disclose:

- the name of its parent;
- the name of its ultimate controlling party (which could be an individual or another entity);
- if neither the parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does produce such statements.

9.8.5 Disclosure of compensation of key management personnel

'Compensation' in this context includes employee benefits as defined in IAS 19 – *Employee benefits* – including those 'share based' employee benefits to which IFRS 2 – *Share-based payment* – applies. These disclosures are required under the following headings:

- short-term employee benefits;
- post-employment benefits;
- other long-term benefits (e.g. accrued sabbatical leave);
- termination benefits;
- share-based payment.

9.8.6 Disclosure of related party transactions

A related party transaction is a transfer of resources or obligations between a reporting entity and a related party, regardless of whether a price is charged. Where such transactions have occurred, the entity should disclose the nature of the related party relationship as well as information about those transactions and outstanding balances to enable a user to understand the potential effect of the relationship on the financial statements. As a minimum, the disclosures should include:

- the amount of the transactions;
- the amount of the outstanding balances and:
  - their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
  - details of any guarantees given or received;
- provisions for doubtful debts related to the amount of outstanding balances; and
- the expense recognised during the period in respect of bad or doubtful debts due from related parties.

These disclosures should be given separately for each of the following categories:

- the parent;
- entities with joint control or significant influence over the reporting entity;
- subsidiaries;
- associates;
- joint ventures in which the entity is a venturer;
- key management personnel of the entity or its parent;
- other related parties.

The following are examples of transactions that are disclosed if they are with a related party:

- purchases or sale of goods, property or other assets;
- rendering or receiving of services;
- leases;
- transfers of research and development;
- transfers under licence agreements;
- transfers under finance agreements;
- provision of guarantees;
- future commitments;
- settlement of liabilities on behalf of the entity or by the entity on behalf of the related party.

The following extract from the Unilever 2009 Annual Report is an example of the required disclosures:

> **30 Related party transactions**
> The following related party balances existed with associate or joint venture businesses at 31 December:

Related party balances	€ million **2009**	€ million 2008
Trading and other balances due from joint ventures	**231**	240
Trading and other balances due from/(to) associates	**5**	(33)

Joint ventures
Unilever completed the restructuring of its Portuguese business as at 1 January 2007. Sales by Unilever group companies to Unilever Jeronimo Martins and Pepsi Lipton International were €91 million and €14 million in 2009 (2008: €84 million and €12 million) respectively. Sales from Jeronimo Martins to Unilever group companies were €46 million in 2009 (2008: €48 million). Balances owed by/(to) Unilever Jerónimo Martins and Pepsi Lipton International at 31 December 2009 were €230 million and €1 million (2008: €238 million and €2 million) respectively.

Associates
At 31 December 2009 the outstanding balance receivable from Johnson Diversey Holdings Inc. was €5 million (2008: balance payable was €33 million). Agency fees payable to Johnson Diversey in connection with the sale of Unilever branded products through their channels amounted to approximately €20 million in 2009 (2008: €24 million).

Langholm Capital Partners invests in private European companies with above-average longer-term growth prospects. Since the Langholm fund was launched in 2002, Unilever has invested €76 million in Langholm, with an outstanding commitment at the end of 2009 of €21 million. Unilever has received back a total of €123 million in cash from its investment in Langholm.

Physic Ventures is an early stage venture capital fund based in San Francisco, focusing on consumer-driven health, wellness and sustainable living. Unilever has invested €20 million in Physic Ventures since the launch of the fund in 2007. At 31 December 2009 the outstanding commitment with Physic Ventures was €43 million.

9.8.7 Exemption from disclosures re: government-related entities

A reporting entity is exempt from the detailed disclosures referred to in 9.7 above in relation to related party transactions and outstanding balances with:

- a government that has control, joint control or significant influence over the reporting entity; and
- another entity that is a related party because the same government has control, joint control or significant influence over both parties.

If this exemption is applied, the reporting entity is nevertheless required to make the following disclosures about transactions with government-related entities:

- the name of the government and the nature of its relationship with the reporting entity;
- the following information in sufficient detail to enable users of the financial statements to understand the effect of related party transactions:
  - the nature and amount of each individually significant transaction; and
  - for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

The reason for the exemption is essentially pragmatic. In some jurisdictions where government control is pervasive it can be difficult to identify other government related entities. In some circumstances the directors of the reporting entity may be genuinely unaware of the related party relationship. Therefore, the basis of conclusions to IAS 24 (BC 43) states that, in the context of the disclosures that **are** needed in these circumstances:

> The objective of IAS 24 is to provide disclosures necessary to draw attention to the possibility that the financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties. To meet that objective, IAS 24 requires some disclosure when the exemption applies. Those disclosures are intended to put users on notice that related party transactions have occurred and to give an indication of their extent. The Board did not intend to require the reporting entity to identify **every** government-related entity, or to quantify in detail **every** transaction with such entities, because such a requirement would negate the exemption.

Summary

The published accounts of a listed company are intended to provide a report to enable shareholders to assess current year stewardship and management performance and to predict future cash flows.

In order to assist shareholders to predict future cash flows with an understanding of the risks involved, more information has been required by the IASB. This has taken two forms:

1 more quantitative information in the accounts, e.g. segmental analysis, and the impact of changes on the operation, e.g. a breakdown of turnover, costs and profits for both new and discontinued operations; and

2 more qualitative information, e.g. related party disclosures and events occurring after the reporting period.

REVIEW QUESTIONS

1 Explain the criteria that have to be satisfied when identifying an operating segment.

2 Explain the criteria that have to be satisfied to identify a reportable segment.

3 Explain why it is necessary to identify a chief operating decision maker and describe the key identifying factors.

4 Explain the conditions set out in IFRS 5 for determining whether operations have been discontinued and the problems that might arise in applying them.

5 Explain the conditions that must be satisfied if a non-current asset is to be reported in the statement of financial position as held for sale.

6 'Annual accounts have been put into such a straitjacket of overemphasis on uniform disclosure that there will be a growing pressure by national bodies to introduce changes unilaterally which will again lead to diversity in the quality of disclosure. This is both healthy and necessary.' Discuss.

7 Explain the circumstances in which an event that is normally non-adjusting is required to be adjusted.

8 Explain how to identify key personnel for the purposes of IAS 24 and why this is considered to be important.

EXERCISES

An extract from the solution is provided on the Companion Website (www.pearsoned.co.uk/elliott-elliott) for exercises marked with an asterisk (*).

* Question 1

Filios Products plc owns a chain of hotels through which it provides three basic services; restaurant facilities, accommodation, and leisure facilities. The latest financial statements contain the following information:

Statement of financial position of Filios Products

	£m
ASSETS	
Non-current assets at book value	1,663
Current assets	
Inventories and receivables	381
Bank balance	128
	509
Total Assets	**2,172**
EQUITY AND LIABILITIES	
Equity	
Share capital	800
Retained earnings	1,039
	1,839
Non-current liabilities:	
Long-term borrowings	140
Current liabilities	193
Total Equity and liabilities	**2,172**

Statement of comprehensive income of Filios Products

	£m	£m
Revenue		1,028
Less: Cost of sales	684	
Administration expenses	110	
Distribution costs	101	
Interest charged	14	(909)
Net profit		119

The following breakdown is provided of the company's results into three divisions and head office:

	Restaurants	*Hotels*	*Leisure*	*Head office*
	£m	*£m*	*£m*	*£m*
Revenue	508	152	368	—
Cost of sales	316	81	287	—
Administration expenses	43	14	38	15
Distribution costs	64	12	25	—
Interest charged	10	—	—	4
Non-current assets at book value	890	332	364	77
Inventories and receivables	230	84	67	—
Bank balance	73	15	28	12
Payables	66	40	56	31
Long-term borrowings	100	—	—	40

Required:

(a) Outline the nature of segmental reports and explain the reason for presenting such information in the published accounts.

(b) Prepare a segmental statement for Filios Products plc for complying, so far as the information permits, with the provisions of IFRS 8 – *Operating Segments* – so as to show for each segment and the business as a whole:
  (i) Revenue;
  (ii) Profit;
  (iii) Net assets.

(c) Examine the relative performance of the operating divisions of Filios Products. The examination should be based on the following accounting ratios:
  (i) Operating profit percentage;
  (ii) Net asset turnover;
  (iii) Return on net assets.

Question 2

IAS 10 deals with events after the reporting period.

Required:

(a) Define the period covered by IAS 10.

(b) Explain when should the financial statements be adjusted?

(c) Why should non-adjusting events be disclosed?

(d) A customer made a claim for £50,000 for losses suffered by the late delivery of goods. The main part (£40,000) of the claim referred to goods due to be delivered before the year end. Explain how this would be dealt with under IAS 10.

(e) After the year end a substantial quantity of inventory was destroyed in a fire. The loss was not adequately covered by insurance. This event is likely to threaten the ability of the business to continue as a going concern. Discuss the matters you would consider in making a decision under IAS 10.

(f) The business entered into a favourable contract after the year end that would see its profits increase by 15% over the next three years. Explain how this would be dealt with under IAS 10.

* Question 3

Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 31 March 2009 are being prepared. The board of directors is responsible for all key financial and operating decisions, including the allocation of resources.

Your assistant is preparing the first draft of the statements. He has a reasonable general accounting knowledge but is not familiar with the detailed requirements of all relevant financial reporting standards. There are two issues on which he requires your advice and he has sent you a note as shown below:

Issue 1

We intend to apply IFRS 8 – *Operating Segments* – in this year's financial statements. I am aware that this standard has attracted a reasonable amount of critical comment since it was issued in November 2006.

The board of directors receives a monthly report on the activities of the five significant operational areas of our business. Relevant financial information relating to the five operations for the year to 31 March 2009, and in respect of our Head office, is as follows:

Operational area	*Revenue for year to 31 March 2009*	*Profit/(loss) for year to 31 March 2009*	*Assets at 31 March 2009*
	$000	*$000*	*$000*
A	23,000	3,000	8,000
B	18,000	2,000	6,000
C	4,000	(3,000)	5,000
D	1,000	150	500
E	3,000	450	400
Sub-total	49,000	2,600	19,900
Head office	Nil	Nil	6,000
Entity total	49,000	2,600	25,900

I am unsure of the following matters regarding the reporting of operating segments:

- How do we decide on what our operating segments should be?
- Should we report segment information relating to head office?
- Which of our operational areas should report separate information? Operational areas A, B and C exhibit very distinct economic characteristics but the economic characteristics of operational areas D and E are very similar.
- Why has IFRS8 attracted such critical comment?

Issue 2

I note that on 31 January 2009 the board of directors decided to discontinue the activities of a number of our subsidiaries. This decision was made, I believe, because these subsidiaries did not fit into the long-term plans of the group and the board did not consider it likely that the subsidiaries could be sold. This decision was communicated to the employees on 28 February 2009 and the activities of the subsidiaries affected were gradually curtailed starting on 1 May 2009, with an expected completion date of 30 September 2009. I have the following information regarding the closure programme:

(a) All the employees in affected subsidiaries were offered redundancy packages and some of the employees were offered employment in other parts of the group. These offers had to be accepted or rejected by 30 April 2009. On 31 March 2009 the directors estimated that the cost of redundancies would be $20 million and the cost of relocation of employees who accepted alternative employment would be $10 million. Following 30 April 2009 these estimates were revised to $22 million and $9 million respectively.

(b) Latest estimates are that the operating losses of the affected subsidiaries for the six months to 30 September 2009 will total $15 million.

(c) A number of the subsidiaries are leasing properties under non-cancellable operating leases. I believe that at 31 March 2009 the present value of the future lease payments relating to these properties totalled $6 million. The cost of immediate termination of these lease obligations would be $5 million.

(d) The carrying values of the freehold properties owned by the affected subsidiaries at 31 March 2008 totalled $25 million. The estimated net disposal proceeds of the properties are $29 million and all properties should realise a profit.

(e) The carrying value of the plant and equipment owned by the affected subsidiaries at 31 March 2008 was $18 million. The estimated current disposal proceeds of this plant and equipment is $2 million and its estimated value in use (including the proceeds from ultimate disposal) is $8 million.

I am unsure regarding a number of aspects of accounting for this decision by the board. Please tell me how the decision to curtail the activities of the three subsidiaries affects the financial statements.

Required:
Draft a reply to the questions raised by your assistant.

Question 4

Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 30 September 2008 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a transaction and has asked for your advice. Details of the transaction are given below.

On 31 August 2008 the directors decided to close down a business segment which did not fit into its future strategy. The closure commenced on 5 October 2008 and was due to be completed on 31 December 2008. On 6 September 2008 letters were sent to relevant employees offering voluntary redundancy or redeployment in other sectors of the business. On 13 September 2008 negotiations commenced with relevant parties with a view to terminating existing contracts of the business segment and arranging sales of its assets. Latest estimates of the financial implications of the closure are as follows:

(i) Redundancy costs will total $30 million, excluding the payment referred to in (ii) below.

(ii) The pension plan (a defined benefit plan) will make a lump sum payment totalling $8 million to the employees who accept voluntary redundancy in termination of their rights under the plan. Epsilon will pay this amount into the plan on 31 January 2009. The actuaries have advised that the accumulated pension rights that this payment will extinguish have a present value of $7 million and this sum is unlikely to alter significantly before 31 January 2009.

(iii) The cost of redeploying and retraining staff who do not accept redundancy will total $6 million.

(iv) The business segment operates out of a leasehold property that has an unexpired lease term of ten years from 30 September 2008. The annual lease rentals on this property are $1 million, payable on 30 September in arrears. Negotiations with the owner of the freehold indicate that the owner would accept a single payment of $5.5 million in return for early termination of the lease. There are no realistic opportunities for Epsilon to sub-let this property. An appropriate rate to use in any discounting calculations is 10% per annum. The present value of an annuity of $1 receivable annually at the end of years 1 to 10 inclusive using a discount rate of 10% is $6.14.

(v) Plant having a net book value of $11 million at 30 September 2008 will be sold for $2 million.

(vi) The operating losses of the business segment for October, November and December 2008 are estimated at $10 million.

Your assistant is unsure of the extent to which the above transactions create liabilities that should be recognised as a closure provision in the financial statements. He is also unsure as to whether or not the results of the business segment that is being closed need to be shown separately.

Required:
Explain how the decision to close down the business segment should be reported in the financial statements of Epsilon for the year ended 30 September 2008.

Question 5

Omega prepares financial statements under International Financial Reporting Standards. In the year ended 31 March 2007 the following transactions occurred:

Transaction 1
On 1 April 2006 Omega began the construction of a new production line. Costs relating to the line are as follows:

Details	*Amount* *$000*
Costs of the basic materials (list price $12.5 million less a 20% trade discount)	10,000
Recoverable sales taxes incurred, not included in the purchase cost.	1,000
Employment costs of the construction staff for the three months to 30 June 2006 (Note 1)	1,200
Other overheads directly related to the construction (Note 2)	900
Payments to external advisors relating to the construction	500
Expected dismantling and restoration costs (Note 3)	2,000

Note 1
The production line took two months to make ready for use and was brought into use on 30 June 2006.

Note 2
The other overheads were incurred in the two months ended 31 May 2006. They included an abnormal cost of $300,000 caused by a major electrical fault.

Note 3
The production line is expected to have a useful economic life of eight years. At the end of that time Omega is legally required to dismantle the plant in a specified manner and restore its location to an acceptable standard. The figure of $2 million included in the cost estimates is the amount that is expected to be incurred at the end of the useful life of the production plant. The appropriate rate to use in any discounting calculations is 5%. The present value of $1 payable in eight years at a discount rate of 5% is approximately $0.68.

Note 4
Four years after being brought into use, the production line will require a major overhaul to ensure that it generates economic benefits for the second half of its useful life. The estimated cost of the overhaul, at current prices, is $3 million.

Note 5
Omega computes its depreciation charge on a monthly basis.

Note 6
No impairment of the plant had occurred by 31 March 2007.

Transaction 2
On 31 December 2006 the directors decided to dispose of a property that was surplus to requirements. They instructed selling agents to procure a suitable purchaser and advertised the property at a commercially realistic price.

The property was being measured under the revaluation model and had been revalued at $15 million on 31 March 2006. The depreciable element of the property was estimated as $8 million at 31 March 2006 and the useful economic life of the depreciable element was estimated as 25 years from that date. Omega depreciates its non-current assets on a monthly basis.

On 31 December 2006 the directors estimated that the market value of the property was $16 million, and that the costs incurred in selling the property would be $500,000. The property was sold on 30 April 2007 for $15.55 million, being the agreed selling price of $16.1 million less selling costs of $550,000. The actual selling price and costs to sell were consistent with estimated amounts as at 31 March 2007.

The financial statements for the year ended 31 March 2007 were authorised for issue on 15 May 2007.

Required:
Show the impact of the construction of the production line and the decision to sell the property on the income statement of Omega for the year ended 31 March 2007, and on its balance sheet as at 31 March 2007. You should state where in the income statement and the balance sheet relevant balances will be shown. You should make appropriate references to international financial reporting standards.

(*IFRS*)

Question 6

Omega prepares financial statements under International Financial Reporting Standards. In the year ended 31 March 2007 the following transaction occurred:

Omega follows the revaluation model when measuring its property, plant and equipment. One of its properties was carried in the balance sheet at 31 March 2006 at its market value at that date of $5 million. The depreciable amount of this property was estimated at $3.2 million at 31 March 2006 and the estimated future economic life of the property at 31 March 2006 was 20 years.

On 1 January 2007 Omega decided to dispose of the property as it was surplus to requirements and began to actively seek a buyer. On 1 January 2007 Omega estimated that the market value of the property was $5.1 million and that the costs of selling the property would be $80,000. These estimates remained appropriate at 31 March 2007.

The property was sold on 10 June 2007 for net proceeds of $5.15 million.

Required:
Explain, with relevant calculations, how the property would be treated in the financial statements of Omega for the year ended 31 March 2007 and the year ending 31 March 2008.

Question 7

(a) In 20X3 Arthur is a large loan creditor of X Ltd and receives interest at 20% p.a. on this loan. He also has a 24% shareholding in X Ltd. Until 20X1 he was a director of the company and left after a disagreement. The remaining 76% of the shares are held by the remaining directors.

(b) Brenda joined Y Ltd, an insurance broking company, on 1 January 20X0 on a low salary but high commission basis. She brought clients with her that generated 30% of the company's 20X0 revenue.

(c) Carrie is a director and major shareholder of Z Ltd. Her husband, Donald, is employed in the company on administrative duties for which he is paid a salary of £25,000 p.a. Her daughter, Emma, is a business consultant running her own business. In 20X0 Emma carried out various consultancy exercises for the company for which she was paid £85,000.

(d) Fred is a director of V Ltd. V Ltd is a major customer of W Ltd. In 20X0 Fred also became a director of W Ltd.

Required:
Discuss whether parties are related in the above situations.

Question 8

Maxpool plc, a listed company, owned 60% of the shares in Ching Ltd. Bay plc, a listed company, owned the remaining 40% of the £1 ordinary shares in Ching Ltd. The holdings of shares were acquired on 1 January 20X0.

On 30 November 20X0 Ching Ltd sold a factory outlet site to Bay plc at a price determined by an independent surveyor.

On 1 March 20X1 Maxpool plc purchased a further 30% of the £1 ordinary shares of Ching Ltd from Bay plc and purchased 25% of the ordinary shares of Bay plc.

On 30 June 20X1 Ching Ltd sold the whole of its fleet of vehicles to Bay plc at a price determined by a vehicle auctioneer.

Required:
Explain the implications of the above transactions for the determination of related party relationships and disclosure of such transactions in the financial statements of (a) Maxpool Group plc, (b) Ching Ltd and (c) Bay plc for the years ending 31 December 20X0 and 31 December 20X1.

(ACCA)

Question 9

The following trial balance has been extracted from the books of Hoodurz as at 31 March 2006:

	$000	$000
Administration expenses	210	
Ordinary share capital, $1 per share		600
Trade receivables	470	
Bank overdraft		80
Provision for warranty claims		205
Distribution costs	420	
Non-current asset investments	560	
Investment income		75
Interest paid	10	
Property, at cost	200	
Plant and equipment, at cost	550	
Plant and equipment, accumulated depreciation (at 31.3.2006)		220
Accumulated profits (at 31.3.2005)		80
Loans (repayable 31.12.2010)		100
Purchases	960	
Inventories (at 31.3.2005)	150	
Trade payables		260
Sales		2,010
2004/2005 final dividend paid	65	
2005/2006 interim dividend paid	35	
	3,630	3,630

The following information is relevant:

(i) The trial balance figures include the following amounts for a disposal group that has been classified as 'held for sale' under IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*:

	$000
Plant and equipment, at cost	150
Plant and equipment, accumulated depreciation	15
Trade receivables	70
Bank overdraft	10
Trade payables	60
Sales	370
Inventories (at 31.12.2005)	25
Purchases	200
Administration expenses	55
Distribution costs	60

The disposal group had no inventories at the date classified as 'held for sale'.

(ii) Inventories (excluding the disposal group) at 31.3.2006 were valued at $160,000.

(iii) The depreciation charges for the year have already been accrued.

(iv) The income tax for the year ended 31.3.2006 is estimated to be $74,000. This includes $14,000 in relation to the disposal group.

(v) The provision for warranty claims is to be increased by $16,000. This is classified as administration expense.

(vi) Staff bonuses totalling $20,000 for administration and $20,000 for distribution are to be accrued.

(vii) The property was acquired during February 2006, therefore, depreciation for the year ended 31.3.2006 is immaterial. The directors have chosen to use the fair value model for such an asset. The fair value of the property at 31.3.2006 is $280,000.

Required:

Prepare for Hoodruz:

(a) an income statement for the year ended 31 March 2006; and

(b) a balance sheet as at 31 March 2006.

Both statements should comply as far as possible with relevant International Financial Reporting Standards. No notes to the financial statements are required nor is a statement of changes in equity, but all workings should be clearly shown.

(*The Association of International Accountants*)

Question 10

The following is the draft trading and income statement of Parnell Ltd for the year ending 31 December 2003:

	$m	*$m*
Revenue		563
Cost of sales		310
		253
Distribution costs	45	
Administrative expenses	78	
		123
Profit on ordinary activities before tax		130
Tax on profit on ordinary activities		45
Profit on ordinary activities after taxation – all retained		85
Profit brought forward at 1 January 2003		101
Profit carried forward at 31 December 2003		186

You are given the following additional information, which is reflected in the above statement of comprehensive income only to the extent stated:

1 Distribution costs include a bad debt of $15 million which arose on the insolvency of a major customer. There is no prospect of recovering any of this debt. Bad debts have never been material in the past.

2 The company has traditionally consisted of a manufacturing division and a distribution division. On 31 December 2003, the entire distribution division was sold for $50 million; its book value at the time of sale was $40 million. The profit on disposal was credited to administrative expenses. (Ignore any related income tax.)

3 During 2003, the distribution division made sales of $100 million and had a cost of sales of $30 million. There will be no reduction in stated distribution costs or administration expenses as a result of this disposal.

4 The company owns offices which it purchased on 1 January 2001 for $500 million, comprising $200 million for land and $300 million for buildings. No depreciation was charged in 2001 or 2002, but the company now considers that such a charge should be introduced. The buildings were

expected to have a life of 50 years at the date of purchase, and the company uses the straight-line basis for calculating depreciation, assuming a zero residual value. No taxation consequences result from this change.

5 During 2003, part of the manufacturing division was restructured at a cost of $20 million to take advantage of modern production techniques. The restructuring was not fundamental and will **not** have a material effect on the nature and focus of the company's operations. This cost is included under administration expenses in the statement of comprehensive income.

Required:

(a) State how each of the items 1–5 above must be accounted for in order to comply with the requirements of international accounting standards.

(b) Redraft the income statement of Parnell Ltd for 2003, taking into account the additional information so as to comply, as far as possible, with relevant standard accounting practice. Show clearly any adjustments you make. Notes to the accounts are not required. Where an IAS recommends information to be on the face of the income statement it could be recorded on the face of the statement.

(*The Chartered Institute of Bankers*)

* Question 11

Springtime Ltd is a UK trading company buying and selling as wholesalers fashionable summer clothes. The following balances have been extracted from the books as at 31 March 20X4:

	£000
Auditor's remuneration	30
Income tax based on the accounting profit:	
For the year to 31 March 20X4	3,200
Overprovision for the year to 31 March 20X3	200
Delivery expenses (including £300,000 overseas)	1,200
Dividends: final (proposed – to be paid 1 August 20X4)	200
interim (paid on 1 October 20X3)	100
Non-current assets at cost:	
Delivery vans	200
Office cars	40
Stores equipment	5,000
Dividend income (amount received from listed companies)	1,200
Office expenses	800
Overseas operations: closure costs of entire operations	350
Purchases	24,000
Sales (net of sales tax)	35,000
Inventory at cost:	
At 1 April 20X3	5,000
At 31 March 20X4	6,000
Storeroom costs	1,000
Wages and salaries:	
Delivery staff	700
Directors' emoluments	400
Office staff	100
Storeroom staff	400

Notes:

1 Depreciation is provided at the following annual rates on a straight-line basis: delivery vans 20%; office cars 25%; stores 1%.
2 The following taxation rates may be assumed: corporate income tax 35%; personal income tax 25%.
3 The dividend income arises from investments held in non-current investments.
4 It has been decided to transfer an amount of £150,000 to the deferred taxation account.
5 The overseas operations consisted of exports. In 20X3/X4 these amounted to £5,000,000 (sales) with purchases of £4,000,000. Related costs included £100,000 in storeroom staff and £15,000 for office staff.
6 Directors' emoluments include:

Chairperson	100,000	
Managing director	125,000	
Finance director	75,000	
Sales director	75,000	
Export director	25,000	(resigned 31 December 20X3)
	£400,000	

Required:

(a) Produce a statement of comprehensive income suitable for publication and complying as far as possible with generally accepted accounting practice.

(b) Comment on how IFRS 5 has improved the quality of information available to users of accounts.

Question 12

As the financial controller of SEAS Ltd, you are responsible for preparing the company's financial statements and are at present finalising these for the year ended 31 March 20X8 for presentation to the board of directors. The following items are material:

(i) Costs of £250,000 arose from the closure of the company's factory in Garratt, which manufactured coffins. Owing to a declining market, the company has withdrawn from this type of business prior to the year-end.

(ii) You discover that during February 20X8, whilst you were away skiing, the cashier took advantage of the weakness in internal control to defraud the company of £30,000.

(iii) During the year ended 31 March 20X8, inventories of obsolete electrical components had to be written down by £250,000 owing to foreign competitors producing them more cheaply.

(iv) At a board meeting held on 30 April 20X8, the directors signed an agreement to purchase the business of Mr Hacker (a small computer manufacturer) for the sum of £100,000.

(v) £300,000 of development expenditure, which had been capitalised in previous years, was written off during the year ended 31 March 20X8. This became necessary due to foreign competitors' price cutting, which cast doubt on the recovery of costs from future revenue.

(vi) Dynatron Ltd, a customer, owed the company £50,000 on 31 March 20X8. However, on 15 May 20X8 it went into creditors' voluntary liquidation. Of the £50,000, £40,000 is still outstanding and the liquidator of Dynatron is expected to pay approximately 25p in the pound to unsecured creditors.

(vii) On 30 April 20X8, the company made a 1 for 4 rights issue to the ordinary shareholders, which involved the issue of 50,000 £1 ordinary shares for a sum of £62,500.

Required:
Explain how you will treat the above financial statements, and give a brief explanation of why you are adopting your proposed treatment.

References

1 IFRS 8 *Operating Segments*, IASB, 2006.
2 www.europarl.europa.eu/sides/getDoc.do?Type=TA&Reference=P6-TA-2007-0526&language=EN
3 IFRS 5 *Non-current assets held for sale and discontinued operations*, IASB (revised 2009).
4 IAS 10 *Events after the Reporting Period*, IASB (revised 2003).
5 IAS 24 *Related party disclosures*, IASB (revised 2009).