

On 1 May 2004, Lap purchased 144,000 shares in Top for \$240,000. The balance on the Profit and Loss Account Reserve of Top on 1 May 2004 was \$40,000. Top has not issued any additional shares since 1 May 2004. Both Lap and Top declared their dividends before 31 December 2011.

Relevant rates of exchange are as follows:

Date	Exchange rate (\$ to £1)
1 May 2004	2.0
31 December 2010	1.6
31 December 2011	1.8
Average for the year ended 31 December 2011	1.7

Top is located in America and runs a manufacturing company. The income of Top is denominated and settled in dollars. The sales of the factory are routinely traded in dollars and the selling price is determined initially by local supply and demand.

Top pays 50% of its costs and expenses in pounds sterling with the remainder being incurred locally and settled in dollars. Top's management has a considerable degree of authority and autonomy in carrying out its operations and is not dependent upon Lap for finance.

BALANCE SHEETS AT 31 DECEMBER 2011

	Lap		Top	
	£	£	\$	\$
<i>Fixed assets</i>				
Property, plant and equipment	520,000		320,000	
Investment in Top	<u>120,000</u>	640,000	<u> </u>	320,000
<i>Current assets</i>				
Debtors	131,792		80,000	
Dividend receivable	<u>4,000</u>		<u>0</u>	
	<u>135,792</u>		<u>80,000</u>	
<i>Creditors: amounts falling due within one year</i>				
Creditors	64,000		64,000	
Dividends payable	<u>12,000</u>		<u>8,000</u>	
	<u>76,000</u>	59,792	<u>72,000</u>	8,000
		<u>699,792</u>		<u>328,000</u>
<i>Share Capital & Reserves</i>				
Issued share capital (£1/\$1 shares)		320,000		160,000
Profit and Loss A/C Reserve		<u>379,792</u>		<u>168,000</u>
		<u>699,792</u>		<u>328,000</u>

PROFIT AND LOSS ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2011

	Lap	Top
	£	\$
Profit before tax	80,000	48,000

Tax	<u>(6,400)</u>	<u>(3,200)</u>
Retained profit	<u>73,600</u>	<u>44,800</u>

STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2011

	Lap £	Top \$
Balance at 31 December 2010	638,192	291,200
Profit for the period	73,600	44,800
Dividends declared	<u>(12,000)</u>	<u>(8,000)</u>
Balance at 31 December 2011	<u>699,792</u>	<u>328,000</u>

Required

- a) Prepare the consolidated balance sheet at 31 December 2011, the profit & loss account and the statement of consolidated reserves for the year to that date.

(25 marks)

- b) Evaluating FRS23: *The Effects of Changes in Foreign Exchange Rates*, explain the rationale behind the method you have used to determine the functional currency of Top.

(5 marks)

(TOTAL 30 MARKS)

Question 2

a) TRANSLATION OF THE BALANCE SHEET OF TOP

	\$	Rate	£'000
Property, plant and equipment	320,000	1.8	177,778
Debtors	80,000	1.8	44,444
Creditors	(64,000)	1.8	(35,556)
Dividends	(8,000)	1.8	(4,444)
	<u>328,000</u>		<u>182,222</u>
Issued share capital	160,000	2	80,000
Pre-acquisition reserves	40,000	2	20,000
Post-acquisition reserves	<u>128,000</u>	Balance	<u>82,222</u>
	<u>328,000</u>		<u>182,222</u>

b) CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2011

	£'000	£'000
<i>Fixed assets</i>		
Property, plant and equipment (520,000 + 177,778)		697,778
Goodwill		<u>33,333</u>
		731,111
<i>Current assets</i>		
Debtors (13,792 + 44,444)	<u>176,236</u>	
<i>Current Liabilities</i>		
Creditors (64,000 + 35,556)	99,556	
Dividends (12,000 + 10% x 44,444)	<u>12,444</u>	
		<u>64,236</u>
		<u>795,347</u>
<i>Equity</i>		
Issued share capital		320,000
Retained reserves (W2)		<u>457,125</u>
		777,125
Minority interest (10% x 182,222)		<u>18,222</u>
		<u>795,347</u>

Workings

1. Goodwill

Cost of combination
Less share capital
Pre-acq

160,000
40,000
200,000

240,000

Group share 90%

180,000

Foreign exchange profit

60,000

Rate

2

1.8

£

30,000

3,333

33,333

2. Retained reserves

Lap

£
379,792

Top (95% x 82,222) post-acquisition reserves
Foreign exchange profit on goodwill to date

74,000

3,333

457,125

W1

3. Translation of P+L A/C of Top

\$

Rate

£

Profit before tax

48,000

Tax

(3,200)

Profit after tax

44,800

1.7

1.7

28,235

(1,882)

26,353

e) MOVEMENT ON CONSOLIDATED P+L A/C RESERVE

Balance at 31/12/2010 – Balancing figure
Profit for the year
Dividends – holding co only
Exchange differences (d)
Balance at 31/12/2011

£'000

~~400,000~~ ~~37,318~~

(see below)

399,492

93,318

(12,000)

(23,685)

457,125

b)

The functional currency is a matter of fact and is the currency of the primary economic environment in which the entity operates. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash.

c) CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2011

£'000

Profit before tax (80,000 – 4,000 + 28,235)	104,235
Tax	(8,282)
Profit after tax	95,953
Minority interest (10% x 26353) (W3)	(2,635)
Net profit for the group	<u>93,318</u>

Note: See W3 for the translation of Top's P+L A/C

d) CURRENCY TRANSLATION DIFFERENCES

On retranslation of opening net assets (W4):
At 31 December 2010 (291,200 @ 1.6).
At 31 December 2011 (291,200 @ 1.8)

£
182,000
161,778
(20,222)

£

~~(20,222)~~ (18,200)

Group share (90%)

On retranslation of net profit for the year:
At average rate
At closing rate (44,800 @ 1.8)
Loss
Group 90%

26353
24889
(1464)

(1,318)

~~(3,340)~~

~~2,022~~

~~(1,318)~~

On retranslation of goodwill (W4) Profit in the Year

\$ 60000 AT 1.6

\$ 60000 AT 1.8

37500

33333

(4167)

(4167)

23685
~~(23,685)~~