

UCAPE  
 currency (EUR and USD, respectively), thus the financial statements are prepared using the current rate method. Both subsidiaries are consistently profitable.

	SEK per EUR	SEK per USD
Beginning 2014	8.43	6.32
Average 2014	8.555	6.35
End of 2014	8.88	6.38
Average 2015	9.125	7.595
End of 2015	9.31	8.81

Next, they review the performance and related disclosures by region. The number of stores operated in each region is shown in Exhibit 3.

Year	Eurozone	Sweden	United States	Total
2014	340	99	80	519
2015	400	100	80	580

In preparation for the meeting, Lars looked at the US region and calculated the effect of the change in the SEK/USD exchange rate on the increase in sales from 2014 to 2015. Her notes include the following:

- In 2014, the sales per store, in SEK, were the same for both US and Swedish stores.
- The sales per US store in USD remained constant in 2015.

Eriksson reminds Lars that Trana defines organic growth in retail as coming from two factors:

1. increasing the number of stores, and
2. increasing the sales per store in the local currency.

He says that he wants to provide disclosures related to the organic growth rate in domestic sales per store, by region, and asks Lars to calculate it for the eurozone region where the sales figures (in millions) were SEK18,394 in 2014 and SEK21,640 in 2015.

*Write up starts from here.*

In 2012, at the start of Trana's expansion into North American markets, the company established a subsidiary, Anart Inc., in a South American country to benefit from lower labor and shipping costs. The details of the Anart investment are as follows:

- Anart is 80% owned by Trana with 20% local investment.
- It sells all of its production to Trana and Trana's other subsidiaries and determines the transfer price as full cost plus 5%.
- In 2015, sales (in millions) from Anart to Trana companies were SEK4,485 with net profit of SEK204.
- The corporate tax rate in the country is 10%.

Throughout 2013, the South American country experienced high rates of inflation, approaching 30% per year. Trana had originally assumed that the high inflation rate was temporary, but it has shown

no signs of decreasing and is now a concern. Eriksson and Lars discuss the impact of Anart on Trana's financial statements and Eriksson asks Lars:

"Is the same accounting method being used this year to account for Anart in the consolidated financial statements as in prior years?"

Eriksson reminds Lars that there is a proposal in Sweden to reduce the corporate tax rate from the current 22% to 16.5%. He would like to provide pro-forma disclosures related to the potential change in net income this change could provide for Trana. He reminds Lars that the average tax rate for the eurozone countries where Trana operates is 30% and 25% in the United States. Sweden operates under a tax treaty with all countries in which it has subsidiaries, such that it will owe taxes on foreign earned income to the extent that the Swedish rate exceeds the foreign rate.

In closing the meeting, Eriksson mentions that Trana is undertaking a comprehensive review of its operations in 2016, and its objectives include reducing overall tax costs by lowering its effective tax rate and reducing foreign exchange gains and losses reported on the income statement.

#### Question 1

Using Exhibits 1, 2, and 3 and Lars's notes about the US operations, the change in sales reported for the US region (in SEK millions) explained by the change in the SEK/USD exchange rate in 2015 is *closest* to:

- A. SEK813.
- B. SEK737.
- C. SEK1,432

#### IMP Question 2

Using Eriksson's definition, the organic growth rate in sales per store in the eurozone region between 2014 and 2015 that Lars calculates is *closest* to:

- A. 0%.
- B. 10.3%
- C. -6.2%.

#### Question 3

The *best* estimate of the proportion of Anart's sales that is reflected in Trana's consolidated income statement is:

- A. 0%.
- B. 100%
- C. 80%

#### Question 4

Which of the following is Lars's *most* appropriate answer to Eriksson's question concerning the accounting method used for Anart in 2015?

- A. No, the current rate method is being used, after restating all accounts for the general price index.
- B. Yes, the temporal method is being used, as in past years
- C. No, the current rate method is being used, after restating nonmonetary items for inflation

#### Question 5

If the proposed profit (in SEK n

- A. SEK18.6
- B. SEK31.2
- C. SEK29.8

#### Question 6

Which of the objectives men

- A. Increase th
- B. Initiate a h
- C. Raise the p

**Question 5**

If the proposed reduction in Swedish tax rates had been in effect in 2015, the increase in Trana's net profit (in SEK millions) would have been *closest* to :

- A. SEK18.6
- B. SEK31.2.
- C. SEK29.8

**Question 6**

Which of the following strategies would be *most likely* to help Trana achieve at least one of the objectives mentioned by Eriksson for 2016?

- A. Increase the number of stores in the US region
- B. Initiate a hedge on the net asset position of the eurozone subsidiary
- C. Raise the price at which Anart sells its goods to other group members

**Question 4**

Because Anart is an extension of Trana (Anart sells 100% of its production to the group) its functional currency would be the Swedish krona, not the local currency, and it would be considered an integrated foreign operation. As an integrated foreign operation, Trana would normally, and historically, have accounted for Anart using the temporal method. But the country in which Anart operates is experiencing high inflation; three years (2013–2015) of rates near 30% would exceed the 100% indicator of hyperinflation. Therefore, under IFRS, the nonmonetary items must be adjusted for the loss in purchasing power to better reflect economic reality. Note that only the nonmonetary items are adjusted because monetary ones would already be expressed in the monetary unit current at the balance sheet date.

**Question 5**

The proposed change in Swedish tax rates would have affected the income earned in Sweden (SEK338 before tax) and the pre-tax income earned in the South American subsidiary (SEK227, see calculation in following table), because the tax rate there is lower than in Sweden and hence subject to tax at Swedish rates. The income earned in tax jurisdictions with rates higher than Sweden's (Europe and the United States) are not subject to tax in Sweden and thus would not have been affected.

		Tax Effect as Reported (22%)	Under Proposal (16.5%)	Difference
Swedish earnings before taxes (EBT)	SEK338	74.4	55.8	SEK18.6
South American EBT <sup>1</sup>	SEK227	50.0	37.4	SEK12.6
Total				SEK31.2

<sup>1</sup>To calculate EBT, divide net profit of SEK204 by (1 - tax rate):  $204 / (1 - 0.10) = \text{SEK}227$ .

**Question 6**

Anart operates in a South American country with the lowest tax rate of the group – 10% versus 25% in the United States, 30% in the eurozone, and 22% (or 16.5%) in Sweden. If more of the corporate profits are earned by Anart, the effective tax rate will decrease.

- Anart currently earns a return of  $204 / 4,485 = 4.5\%$ , whereas the overall corporate profit rate is 10.3% ( $3,096 / 30,200$ ).
- Any income taxed in South America would be eligible for a tax credit in Sweden, and Trana would be liable for the tax difference between the local 10% rate and the rate in Sweden (22% or 16.5%).
- To the extent that taxable income can be diverted from the US or eurozone operations (where the rates are higher than Sweden's), it would result in an overall tax saving for Trana.
- By increasing the price at which Anart sells goods to the US and eurozone subsidiaries, it would increase the taxable income earned in South America and reduce the taxable income (through higher cost of goods sold) in the United States and the eurozone. Because of the tax treaty with Sweden, there would be no net tax savings on the goods sold to US and eurozone stores by

Anart if the prices change.

Because both retail subsidiaries are translated using the current rate method, all foreign exchange gains/losses are reported in other comprehensive income not on the income statement. Therefore, the effects of hedging the exposure in the eurozone subsidiary would also be reported in other comprehensive income and not affect the income statement.