CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

ADVANCED CORPORATE REPORTING

PROFESSIONAL 2 EXAMINATION - APRIL 2015

NOTES:
You are required to answer **ALL** Questions.

Provided are pro-forma:

Statements of Profit or Loss and Other Comprehensive Income By Expense, Statements of Profit or Loss and Other Comprehensive Income By Function, and Statements of Financial Position.

Time Allowed
3.5 hours plus **20 minutes** to read the paper.

Examination Format
This is an open book examination. Hard copy material may be consulted during this examination, subject to the limitations advised on the Institute's website.

Reading Time
During the reading time you may write notes on the examination paper but you may not commence writing in your answer booklet.

Marks
Marks for each question are shown. A mark of 50 or more is required to achieve a pass in this paper.

Answers
Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills, and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.

Answer Booklets
List on the cover of each answer booklet, in the space provided, the number of each question attempted. Additional instructions are shown on the front cover of each answer booklet.

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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Time Allowed: 3.5 hours, plus **20 minutes** to read the paper. You are required to answer **ALL** questions.

If you make an assumption in any question, please state your assumption clearly.

Case Study

It is February 2015, and you are employed as a Certified Public Accountant (CPA) with Mascot plc (Mascot) an Irish listed manufacturing company producing visual and audio equipment. The strategic plan of the company is to specialise in audio equipment with the ultimate objective of becoming the market leader in the sector. Whilst you only joined the company in November 2014, you have been disappointed not to have been given any substantial responsibility in terms of preparing the year-end financial statements for Mascot. The Finance Director, Marcus, has been busy searching for new overseas markets and potential acquisition targets and, consequently, you have not had many opportunities to discuss your workload with him. Apart from Marcus, there are two other staff members within the finance division, Maria and Jamil. Maria, also a qualified CPA, has been employed with the company for the last four years and works incredibly long hours. Jamil is studying for his accounting technician examinations, having joined the company a week before you. Having recently qualified as a CPA, you are very eager to take on more responsibility. At the end of last year, there were rumours that Marcus had been having some personal problems and that he was under considerable stress. Indeed, your own working relationship with Maria has been difficult because she is inclined to keep information to herself and has not been helpful in answering your questions. She recently informed you that Marcus, and the Managing Director, have been involved in negotiations with official representatives of a foreign government about the feasibility of Mascot supplying a range of audio equipment for 145 government-run schools. The award of the contract could be significant, and would help the company to develop its international presence and reputation. Negotiations are at an advanced stage. You are aware that the directors are considering presenting the foreign government's representatives with some Irish crystal in recognition of the good relations that have been developed.

Mascot, acquired an investment in Potter Limited (Potter) on 1 January 2013 and another investment in Hogwart Limited (Hogwart) on 1 January 2014. Further details of the acquisitions are provided in **Appendix 1 (Note 2)**. You are also aware that on 1 January 2014, Mascot issued 8 million 9% debentures at an issue price of 95 cent for every €1 debenture. The direct costs associated with the issue amounted to €84,000. You are currently working in Mascot's head office in Dundalk which is very convenient as you live only about ten minutes drive away. However, you are concerned about a conversation you had with Maria, whereby she informed you that the directors are considering selling the freehold building and moving to larger purpose-built premises in Dublin, which is over 90kms away. She mentioned that a structural survey of the existing premises was completed in December 2014 which revealed the presence of asbestos in part of the roof. The cost of remedial work is estimated at €1.5 million and the builder who completed the survey has offered to purchase the building. The amount that would be receivable (after deducting selling expenses) would be €3.5 million. You were pleased to learn that the directors have not made a final decision regarding the relocation. The carrying value of the building was €4.3 million at 31 December 2014, unadjusted for the effects of any remedial work. The value in use at that date was estimated to be €3.4 million. It is your understanding that Marcus has made a provision of €1.5 million in current liabilities for the remedial work, with a corresponding charge to cost of sales (Apparently, the building does not qualify as being an asset held for resale under IFRS 5 *Non-current assets held for sale and discontinued operations*).

It is a cold Tuesday morning in February and you get a phone call from Marcus asking you to meet him in his room for a coffee. As well as being uneasy about the level of accounting work you have been getting, you are also worried, assuming the sale of head office goes ahead, about the implications of having to travel to Dublin. You call into Marcus's office:

"Hello, have a seat" he says. *"I thought it would be good for us to catch up over a coffee as I know it has been a long time since we had a chat. You know I have been busy working on sourcing some overseas acquisitions and, I am pleased to say, we will be signing an agreement with the government of Bansal to supply 145 of their schools with audio equipment. I know you have not had the chance to do much high level financial accounting over the last couple of months so I want your assistance. I have drafted the individual financial statements* ***(See Appendix 1)*** *of Mascot, and our new investments in Potter (acquired on 1 January 2013) and Hogwart (acquired 1 January 2014). The board of directors asked me to provide it with a copy of the consolidated financial statements together with an explanation regarding any outstanding matters. I will need this information for the board meeting at the end of next week. Please provide an explanation of any necessary accounting adjustments, and complete the relevant calculations. As a recently qualified CPA, you know more about the technical application of International Financial Reporting Standards (IFRSs) than I do. By the way, do not let the other directors know that you are doing the work. For a variety of reasons, it is better that they think it is me who has completed the work. I have spoken to Maria and we are both of the opinion that we should not recognise the lease in the*

statement of financial position and, therefore, when you are preparing the financial statements either ignore it or show it as an operating lease. Maria thinks that despite the company being responsible for all maintenance costs associated with the asset, the lease does not meet the criteria for a finance lease and we certainly don't want to show extra liabilities if it can be avoided. The directors do not like to see too many impairment charges going through the financial statements. However, as IAS 36 Impairment is fairly subjective, we should have some scope in terms of deciding appropriate discount rates and recoverable amounts. Finally, I need to provide some information to a friend of mine who runs a medium-sized company. I understand there is a new accounting standard (FRS102) which can be applied in preparing the financial statements of medium-sized companies. Can you provide me with some more information, particularly regarding the advantages and disadvantages of preparing a set of financial statements under this standard?"

Marcus then hands you a lever arch file labelled outstanding issues for the year ended 31 December 2014. You leave to go back to your office. On the way, you meet Maria who informs you that she has been told that the directors have decided to go ahead with the relocation of the head office to Dublin. Arriving back at your office you open the lever arch file and begin to read through the ten outstanding issues listed below. As you are reading these, you begin to reflect upon whether you wish to stay working with the company, particularly now given that you will have to travel to Dublin. You begin to think it might be time to start looking for a job in a smaller organisation. You quickly refocus your mind and begin to work on the outstanding issues; it is going to be a long week.

Outstanding Issues:

1. The intangible assets of Potter include €9 million of training and marketing expenditure incurred during the year ended 31 December 2014. The directors of Potter believe that these should be capitalised as they relate to the start-up period of a new business venture in Cavan, and they intend to amortise the balance over the five years commencing 1 January 2015. On 1 July 2014, Mascot purchased a customer list from the liquidator of a competitor. The price paid was €4 million and was based on the list having a useful life of two years. At 31 December 2014, Marcus commissioned a report on the value of the customer list from a firm of independent valuers. The firm has valued the customer list at €5 million and estimates a total useful life of five years. The customer list is currently included in intangible assets at a carrying value of €4 million but Marcus wants the list to be revalued to the higher amount.

2. During the year to 31 December 2014, Potter sold goods to Mascot for €130 million. The company makes a profit of 25% on the selling price. At the year end there was €14 million of these goods in inventory.

3. Potter sold a package of products (to external customers) for €3 million cash on 1 October 2014. The package comprised equipment (with a normal retail value of €2.25 million) and twelve months of helpline support (with a normal retail price of €1.5 million). Revenue of €3 million has been recognised in the draft financial statements. The managing director is of the opinion that this reflects the reality of the situation as the hard work was closing the sale and the future costs of the helpline support are immaterial.

4. In January 2015, a customer commenced legal action against Mascot, alleging that delivery and installation of audio equipment had not been carried out in accordance with the contract. The directors intend to defend the allegations vigorously and Mascot's legal advisors estimate the company has a 75% chance of successfully defending the claim. If the customer is successful, penalties and legal fees are expected to amount to €4 million. Should Mascot successfully defend the case, non-recoverable fees of €0.5 million will have been incurred. Marcus is proposing to omit any reference to the legal action in the financial statements for the year ended 31 December 2014 as the writ was not issued until January 2015. Marcus is also concerned that drawing attention to the claim would not be good for the reputation of the company.

5. On 1 January 2014, Mascot entered into a lease agreement to rent an asset for a six-year period, with annual payments of €368,400, made in advance. The market price of the asset was €1,720,000. The present value of minimum lease payments amounts to €1,680,000, discounted at the implicit interest rate shown in the lease agreement of 12.5%. Mascot expects to sell goods generated by the asset during the first five years of the lease term, but has leased the asset for six years as this is the requirement stipulated by the lessor.

6. On the 31 January 2015, €500,000 was paid to John Rowlings as compensation for his removal as Mascot's Director of Marketing. As a result of a disagreement over the marketing strategy of the company, Mr Rowlings was dismissed by the Managing Director at the board meeting on 31 December 2014. In addition, a customer of Mascot went into liquidation owing Mascot €1 million at 31 December 2014. Information in relation to the liquidation suggests that there is little chance that unsecured creditors will receive any money. The debt has increased to €1.2 million at the date of the winding-up order.

7. Due to a change in Mascot's product portfolio plans, an item of machinery with a carrying value of €22 million at 31 December 2014 (after adjusting for depreciation for the year) may be impaired due to a change in use. An impairment test, conducted on 31 December 2014, revealed its fair value less costs of disposal to be €16 million. The asset is now expected to generate an annual net income of €3.8 million for the next five years at which point it would be disposed of for €4.2 million. An appropriate discount rate is 10%. Mascot charges depreciation at 20% on reducing balance method on machinery and equipment.

8. Mascot will redeem the debentures on 31 December 2017 at a premium of 10 cent for every €1 debenture purchased. The effective rate of interest on the debenture is 10%. While the initial debenture issue has been recorded in the financial statements, no other accounting entries in respect of the issue have been made.

9. On 1 March 2014, Mascot commissioned a state-of-the-art piece of equipment to be constructed for €2 million. The equipment was ready for use, on time, on 1 January 2015 and has an estimated useful life of eight years. A loan was taken out on 1 March 2014 for the full €2 million, as payment for the equipment was payable on the same date. The interest on the loan is 7% per annum and it is repayable after two years. The only accounting entries made were to recognise the loan on its receipt and the equipment as part of property, plant and equipment.

   Ignore any depreciation in relation to the new piece of equipment.

10. Annual impairment tests have indicated impairment losses of €10 million relating to the recognised goodwill of Potter, including €3 million in respect of the year ended 31 December 2014. There has been no indication of any impairment losses to date in respect of the investment in Hogwart.

REQUIREMENT:

(a) Prepare a memorandum for Marcus that includes:

(i) An explanation and an analysis of the required IFRS accounting treatment for each of the outstanding issues 1, 3, 4, 5, 6, 7 and 8. You should prepare relevant calculations and discuss the impact, where appropriate, on the consolidated statement of profit or loss and other comprehensive income and the consolidated statement of financial position for the Mascot Group for the year ended 31 December 2014.

(40 Marks)

(ii) The consolidated Statement of Profit or Loss and Other Comprehensive Income and Statement Of Financial Position of the Mascot Group for the year ended 31 December 2014 in accordance with relevant IFRS.

(28 Marks)

Format & presentation (2 Marks)

(b) Evaluate critically the ethical issues arising from the information provided in the case study, and outline appropriate steps which should be taken by you to address them.

(9 Marks)

(c) (i) Drawing on Marcus's comments on the case study, appraise with relevance to the Group, the factors which would be important when conducting an impairment test under IAS 36 *Impairment of Assets.*

(11 Marks)

(ii) Evaluate whether the use of fair value accounting to measure all financial instruments may result in less complexity in accounting for financial instruments, but may lead to more ambiguity in financial statements.

(5 Marks)

(iii) Outline the advantages, for a medium-sized company, of preparing financial statements under FRS102, the Financial Reporting Standard applicable in Ireland and the United Kingdom.

(5 Marks)

[Total: 100 Marks]

APPENDIX 1:

Draft
Statements of Financial Position for Mascot, Potter and Hogwart as at 31 December 2014

	Mascot €m	Potter €m	Hogwart €m
ASSETS			
Non-current assets			
Property, plant and equipment	97	92	44
Intangible assets	4	35	3
Investment in Potter	77	-	-
Investment in Hogwart	20	-	-
	198	127	47
Current assets			
Inventories	62	146	21
Trade receivables	95	53	33
Cash	90	51	3
	247	250	57
Total Assets	445	377	104
EQUITY and LIABILITES			
Issued capital 1€ ordinary shares	100	40	20
Share premium	20	14	8
Retained earnings	113	81	26
Revaluation surplus	14	7	6
Total equity	247	142	60
Non-current liabilities	10	5	4
Current liabilities	188	230	40
	198	235	44
Total Equity and Liabilities	445	377	104

Draft Statements of Profit or Loss and Other Comprehensive Income
for the Year Ended 31 December 2014

	Mascot €m	Potter €m	Hogwart €m
Revenue	448	420	146
Cost of sales	(269)	(294)	(102)
Gross profit	179	126	44
Distribution and administrative costs	(62)	(29)	(20)
Finance costs	(5)	(8)	(2)
Dividend income (Potter and Hogwart)	26	-	-
Profit before tax	138	89	22
Income tax expense	(33)	(27)	(7)
Profit for the year	105	62	15
Other comprehensive income			
Gain on revaluation of property	3	1	1
Total comprehensive income for the year	108	63	16

Note 1:

	Mascot €m	Potter €m	Hogwart €m
Dividends paid in the year	25	30	8
Retained earnings brought forward	33	49	19

Note 2:

(i) Details of the acquisitions made by Mascot at their respective dates are as follows:

Investment	1€ Ordinary Share capital m	Share premium €m	Retained earnings €m	Revaluation surplus €m	Fair value of net assets at date of acquisition €m	Cost of investment acquired €m	1€ Ordinary shares acquired m
Potter	40	14	12	4	80	77	32
Hogwart	20	8	19	5	65	20	5

(ii) The fair value difference on Potter relates to property, plant and equipment being depreciated through cost of sales over a remaining life of ten years from the date of acquisition. The fair value difference on Hogwart relates to a piece of land (which has not been sold since acquisition).

(iii) The Group policy is to measure non-controlling interests on the acquisition date at fair value. The fair value of non-controlling interests on 1 January 2013 was calculated at €19 million.

Other information:

The 10% relevant present value (PV) and annuity rates are as follows:

Year	PV	Annuity
1	0.909	0.909
2	0.826	1.736
3	0.751	2.487
4	0.683	3.170
5	0.621	3.791

END OF PAPER

SUGGESTED SOLUTIONS

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PROFESSIONAL 2 EXAMINATION - APRIL 2015

SOLUTION 1

(a)

Memorandum Confidential

To: Marcus

From: CPA

Subject: Mascot Group: Commentary on accounting treatment of outstanding issues for financial statements year ended 31 December 2014 and presentation of group financial statements.

Date: xx/xx/xxxx

Hi Marcus,

Further to our recent discussions, I have set out below the accounting treatment for each of the outstanding issues. In each case, I have prepared relevant calculations and discussed the relevant impact(s) on the financial statements. As requested, a draft consolidated statement of profit or loss and other comprehensive income and statement of financial position for the year ending 31 December 2014 has been included in the appendix to this memo. Finally, I have also included some brief notes in relation asset impairment, leasing and the advantages (to medium companies) of preparing financial statements under FRS102.

(i)

Issue 1- intangible assets

IAS 38 *Intangible assets* states that start-up, training and promotional costs should all be written off as an expense as incurred as no intangible asset is created that can be recognised (the benefits cannot be sufficiently distinguished from internally generated goodwill, which is not recognised. Potter's retained earnings will be reduced by €9 million and profit for year and other comprehensive income will be reduced by same amount (with result that NCI share of profits are reduced). The customer list would appear to satisfy the requirements of IAS38, as it is identifiable, non-monetary asset without physical substance. The list is identifiable as it was purchased from a third party. The probability of future economic benefits is always assumed for such a separate acquisition. Mascot has therefore adopted the correct accounting treatment by capitalising the list at its cost of €4 million. However, the list should be amortised over its original useful life of two years. Therefore an amortisation charge of 4/2 x 6/12 = €1. A journal entry should be put through the books of Mascot

		€	€
Dr	Distribution and administration costs (SPLOCI)	1m	
Cr	Intangible assets (SFP)		1m

Issue 3 – Revenue recognition

This is an example of a bundled sale transaction. Where a package of goods and services is sold then the components of the package should be identified, measured and recognised as if sold separately. If the total of the fair values exceeds the overall price of the contract an appropriate approach would be to apply the same discount percentage to each separate component. In this case the package price is (€3 million) is at a discount of 20% to the fair value of the separate components (€2.25 million + €1.5 million). Therefore the two components of the transaction should be accounted for as follows:

- Equipment – revenue of €1.8 million (80% of €2.25 million) recognised immediately
- Helpline services – revenue of €1.2 million (80% x €1.5) should be accounted for on the basis of staged completion.

In the absence of information on costs to date and those expected on completion, a time apportionment is appropriate. Three months have passed and revenue of €0.3 million (3/12 x €1.2 million) should be recognised.

Total revenue recognised in the year to 31 December 2014 would be €2.1 million. This is a reduction of €0.9 million and this should be included in current liabilities as deferred income. Potter is an 80% subsidiary of Mascot and the effect of the adjustment is to reduce the earnings attributable to the group by €0.72 million (80% x €0.9 million) and the NCI by €0.18 million.

Issue 4

The work was completed during the year ended 31 December 2014 and therefore it is relevant to the financial statements for that year. As the legal fees of €0.5 million are non-recoverable, these should be provided for. As a successful outcome is put at 75%, it is reasonable to treat the claim as a contingent liability and disclose by way of note, explaining the background to the claim and the expectations for a successful outcome.

Issue 5

The lease would appear to be a finance lease for the following reasons:

- The present value of lease payments amounts to 98% (€1,680,000/€1,720,000) of the fair value of the asset at the inception of the lease.
- The asset will be used by Mascot for the whole of its useful life, as it will be scrapped by lessor at end of lease.

Consequently, regardless of what Marcus wants in terms of showing the lease as an operating lease the asset must be capitalised (as per IAS 17 Leases). The asset should be depreciated over the shorter of its useful life (five years) and the lease term (six years). A lease liability will be shown in the statement of financial position reduced by lease payments made in advance and increased by interest charged using the implicit rate of 12.5%. Both the asset and the liability will be recorded at €1,680,000, the PV of the minimum lease payments as this is lower than the fair value of the asset. In present value terms the lessor is making a loss of €40,000 by not selling the asset at its market value of €1,720,000.

Carrying value of leased asset

Depreciation €1,680,000/5 = €336,000 (SPLOCI)
Carrying value at end of year €1,680,000 - €336,000 = €1,334,000

		€
1.1.141	PV of minimum lease payments	1,680,000
1.1.14	Payment in advance	(368,400)
		1,311,600
1.1.14 – 31.12.14	Interest at 12.5%	163,950
31.12.14	Lease obligation	1,475,550
1.1.15	Payment in advance	(368,400)
1.1.15	Finance lease liability after next payment	1,107,150

The interest element €163,950 of the current liability can also be shown as interest payable.

Finance costs of €163,950 (SPLOCI)

Statement of Financial Position

	€
Addition to assets (net of depreciation)	1,334,000
Non-current liabilities	
Finance lease liability	1,107,150
Current liabilities	
Finance lease liability (1,273,050 -904,650)	368,400

Issue 6

The dismissal of Mr Rowlings took place before the end of the financial year. As a consequence, the compensation payment of €500,000 will be an adjusting event and will be charged to the financial statements for the year ended 31 December 2014.

The €1m is an adjusting event, and an adjustment should be made to the accounts in respect of the amount owing at the date of statement of financial position. There will be charge to the SPLOCI and a write off in the statement of financial position. No adjustment should be made for the €0.2m as this arose after the date of the statement of financial position. However, if the €0.2m is material, then a note should be attached to the financial statements stating that further debts incurred in respect of a bankrupt customer, after the year end, amounting to €0.2m are unlikely to be recoverable.

Issue 7

Under IAS36 Impairment, The machinery needs to be tested for impairment.

	€m
Carrying value	22
Recoverable amount (€3.8 x 3.791) + (€4.2 x 0.681)	(17.3)
Impairment	4.7

Recoverable amount is the higher of value in use (€17.3m) and fair value less costs of disposal (€16m)

Issue 8

Under IFRS 9 *Financial Instruments* a debt instrument may be measured at amortised cost. A debt instrument that meets the business model test and cash flow characteristics test may be measured at amortised cost. In terms of business model test, the entity must be holding the financial asset to collect the contractual cash flows associated with the financial assets. To pass the cash flow test, the contractual cash flows must consist solely of payment of interest and capital. This would be the case in relation to the debenture issue by Mascot during year ended 31 December 2014. (Assume debentures issued at beginning of the year).

	€m
Proceeds from the debenture issue (€8m x 0.95)	7.6
Issue costs	(0.084)
Net proceeds	7.516

Op. balance	**Amount borrowed**	**Interest 10%**	**Paid 6%**	**Cl. balance**
2014	7.52	0.752	(0.72)	7.55
2015	7.55	0.755	(0.72)	7.59
2016	7.59	0.759	(0.72)	7.63
2017	7.63	0.763	(8.39)	Nil*

*Rounding difference

	€m	€m
Dr SPLOCI –finance costs	0.75	
Cr Bank		0.72
Cr Debentures		0.03

(40 Marks)

(ii) See Appendix for Consolidated Financial Statements. (28 Marks)

Presentation (2 Marks)

W1
Workings – group structure

Mascot

80% (32/40) — Hogwart

25% (5/20) — Potter

W2
Goodwill- Mascot

	€m	€m
Consideration transferred		77
Non-controlling interests		19
FV of identifiable assets acquired and liabilities assumed		
Share capital	40	
Share premium	14	
Revaluation surplus at acquisition	4	
Retained earnings	12	
Fair value adjustment	10	
Fair value of net assets		80
		16
Less cumulative impairment losses		(10)
Goodwill		6

W3
Investment in associate

	€m
Cost	20
Share of post acquisition profits reserves (26 + 6 – 19 – 5) x 25%	2
Impairment loss	(0)
	22

W4 (a)
Retained earnings c/f

	Mascot €m	Potter €m	Hogwart €m
Per case study	104.65*	81	26
PUP (W5)		(3.5)	
Start up costs (Issue 1)		(9)	
Depreciation on FV adjustment (W8)		(2)	
Revenue (Issue 3)		(0.9)	
Less pre-acquisition		(12)	(19)
		53.6	7
Group share			
Potter: 53.6 x 80%	42.9		
Hogwart: 6 x 25%	1.75		
Less group impairment losses:			
Potter: 80% x 10 (W2)	(8)		
Hogwart	(0)		
	141.4		

W4 (b)
Consolidated revaluation surplus

	Mascot	Potter	Hogwart
	€m	**€m**	**€m**
Per case study	14	7	6
Less pre-acquisition	-	(4)	(5)
		3	1
Group share:			
Potter (3 x 80%)	2.4		
Hogwart (1 x 25%)	0.25		
	14.49		

W5
Intra-group trading and unrealised profit

		€m	€m
Dr	Revenue	130	
Cr	Cost of sales		130

In closing inventories (14 x 25%) 3.5

W6
Borrowing costs

Under IAS23 *Borrowing Costs* – capitalise the interest costs 7% x €2m x10/12 = 0.12m

	€m	€m
Dr PPE (SFP)	0.12	
Cr Current liabilities (loan interest) (SFP)		0.12

W7 *Remedial work on Mascot's property*
No provision should be made for the remedial work because the three conditions for recognition described in IAS37 have not been met. A reliable estimate can be made of the amount involved, but there is no present obligation to meet this cost. Mascot could avoid it, for example by selling the property.

The provision needs to be reversed, which would increase profit before taxation by €1.5m, reducing provisions by the same amount. However, the discovery of the asbestos suggests that property has suffered an impairment loss. Assets should be carried at no more than their recoverable amount, which is the higher of fair value less costs to sell and the assets value in use.

Taking the builders estimate of fair value the recoverable amount is €3.5m, so the impairment loss is (4.3-3.5) = €0.8m. This should be recognised in the SPLOCI and the amount of the asset reduced by the same amount.

W8 *Fair value - Potter*

	At Acquisition	Additional Depreciation	At year-end
PPE (80-40-14-12-4)	10	(2)	8

2 year depreciation (since acquisition) 2 x 10/10 =2

W9 *NCI (SFP)*

	€m
At acquisition (W2)	19
Share of post-acquisition retained earnings [53.6 x 20%] W4a	10.72
Share of post-acquisition revaluation surplus [3 x 20%] W4b	0.6
Less impairment loss on goodwill [20% x 10] W4	(2)
	28.32

W10 *NCI (SPLOCI)*

	PFY	TCI
	€m	**€m**
Potter's PFY/TCI per case study	62	63
Less impairment losses (Issue 10)	(3)	(3)
Less PUP(W5)	(3.5)	(3.5)
Less start –up costs(Issue 1)	(9)	(9)
Less FV depreciation (W8)	(1)	(1)
Revenue (Issue 3)	(0.9)	(0.9)
NCI share 20%	8.92	9.12

*

Profits of Mascot adjustments	€m
Per case study	113
Intangibles (Issue 1)	(1)
Depreciation on lease (Issue 5)	(0.34)
Interest on lease (Issue 5)	(0.16)
Legal fees (Issue 4)	(0.5)
Finance costs (Issue 8)	(0.75)
Adjusting events (Issue 6)	(1.5)
Impairment re Mascot's Building	(0.8)
Impairment re Mascots Machine (Issue 7)	(4.7)
Reversal of provision re remedial work	1.5
	104.75

(b) From the case there are potential ethical issue arising for the CPA. As a Certified Public Accountant, you have the duty to demonstrate high standards of professional conduct (integrity) and should act in a professional manner in accordance with CPA Code of Ethics.

There are several ethical issues for professional accountants arising from the information provided in the case. Certified Public Accountants have a duty to demonstrate high standards of professional conduct (including integrity) and should act at all times in a professional manner in accordance with CPA Code of Ethics. The CPA Code of Ethics satisfies the requirements of the Code of Ethics that is set by the International Ethics Standards Board for Accountants (IESBA) and published by the International Federation of Accountants (IFAC). If Marcus is not a member of CPA Ireland then it is to be assumed that, as Finance Director of a listed company, he is a member of a professional body of accountants that itself is a member of IFAC. Therefore he would be obliged to abide by the IAESB's code of ethics (or his own institute's code which must be consistent with the code set by the IAESB).

One of the fundamental principles of the Code of Ethics is professional competence and due care. Marcus is required to maintain his knowledge and skills at an appropriate level: as finance director of a large company an appropriate level would be an in-depth knowledge of International Financial Reporting Standards. Marcus's comments to the newly recruited CPA are a cause for concern. As a newly qualified CPA, you may feel reluctant to challenge Marcus regarding his behaviour. However, you should remind Marcus, as a member of the accountancy profession, of his ethical and professional obligations. You may also wish to consider contacting CPA Ireland for advice and support on the issue.

There is also a concern regarding the comments with respect to the lease transaction ' ...either ignore it or treat it as an operating lease'. The asset clearly meets the definition of set out in the Conceptual Framework and, under IAS17 Leases the asset should be recorded as an asset with a corresponding lease obligation (liability). The lease meets the criteria to be recognised as a finance lease. To try and show this asset as off-balance sheet would be inappropriate and against the requirements for financial statements to show a true and fair view. Marcus and Maria's behaviour in relation to this transaction could be seen as being tantamount to collusion.

In terms of the negotiations with the representatives of the foreign government the following would need to be considered:

- Directors of Mascot have a fiduciary responsibility to act in the best interests of shareholders.
- Gifts should not be seen as an inducement to promote business in manner that is not open and honest.
- Size of gifts (value) is important.
- Payment of 'bribes' to encourage and develop business is not acceptable.
- Organisation should have a policy in relation to dealing with giving and receiving of gifts.

Students should refer to the key themes of the code of ethics: integrity; objectivity; professional competence and due care; confidentiality and professional behaviour.

Other issues could include the relationship between Marcus and Maria. (9 Marks)

(c)

(i) All assets, including goodwill and intangibles, have to be tested for impairment at the end of the reporting period, if there are indicators of impairment. The main issues are as follows:

Change of circumstances
Where annual impairment test is required for goodwill and certain intangible assets, IAS36 Impairment of Assets allows the impairment test to be performed at any time during the period, provided it is performed at the same time each year.

Volatility in financial statement may indicate impairment. For example, a fall in values of property will affect impairment charges for real estate companies.

Allocating and reallocating goodwill to CGUs
Given the complexity, sensitivity and need for significant judgement, companies experience issues assessing goodwill for impairment. In the current case study a goodwill impairment figure has been provided for one CGU (Potter). There is also an impairment issue in relation to an item of machinery. The discount rate has been provided, however there is debate (judgement) over the type of cash flows that should be included in measuring value in use (VIU). In addition, and as mentioned by Marcus in the case study, there are issues in relation to determining the appropriate discount rate to apply. While WACC is often the most commonly used discount rate, there are complex issues surrounding how it is computed. In any event the rate can be subjective. The impact of taxation is also an issue that can cause difficulties.

(11 Marks)

(ii) Over the last couple of years there has been pressure to reduce complexity in accounting for financial instruments. It is argued that fair value is the only appropriate measure for all types of financial instruments, and that a fair value model would be simpler to apply than a mixed model. Students should refer to IFRS13 Fair value measurement sets out disclosure requirements in relation to financial instruments measured at fair values. IFRS13 defines fair values as ‘the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date’. IFRS13 establishes a three-level hierarchy for the inputs that valuation techniques use to measure fair value. The standard also identifies three valuation approaches – income approach, market approach and cost approach.

A single measurement base such as fair value would:
- Reduce the complexity in classification of financial instruments.
- Reduce the complexity in accounting – e.g. impairment losses.
- Eliminates measurement mismatches.
- Better reflect the cash flows that would be paid if liabilities are transferred at remeasurement date.
- Make reported information easier to understand.
- Improve comparability.

However, while fair values have obvious advantages, there are problems as well.
- Markets may not be liquid and transparent.
- Many assets and liabilities do not have an active market.
- Management will, by necessity, exercise judgement in the valuation process.
- Independent verification of fair value estimates is difficult.
- Disclosure provisions are complicated.
- IFRS13 is a move away from stewardship and emphasises the decision usefulness of financial information.

Balanced argument/evidence of wider reading and current practice. (5 Marks)

(iii) Broad range of answers would be acceptable here.

- Shareholders of SMEs are often also directors. Therefore, through managing the company and maintaining the financial records they are already aware of the company's financial performance and position and so do not need the level of detail in financial statements required by external investors.
- Main users of medium company's accounts are lenders therefore don't need level of detail that large institutional shareholders would require.
- Many medium sized companies feel that full IFRS represents and unacceptable burden on preparers.
- Full IFRS requires extensive disclosures which are not all relevant to medium sized organisations.
- Some IFRSs (E.g. IAS16) still allow a choice of accounting treatment, leading to lack of comparability.

(5 Marks)

[Total: 100 Marks]

Appendix 1:

Mascot Group
Consolidated Statement of Financial Position as at 31 December 2014

	€m
Non-current assets	
Property, plant and equipment: 97 + 92 + 8 (W8) + 1.33(Issue 5) + 0.12(W6) - 0.8(W7) – 4.7(Issue 7)	192.90
Goodwill (W2)	6.00
Other intangible assets 4 + 35 – 9(Issue 1) - 1(Issue 1)	29.00
Investment in associate (W3)	22.00
	249.90
Current assets	
Inventories (62 + 146 – 3.5(W5))	204.50
Trade receivables (95 + 53 - 1 (Issue 6))	147.00
Cash (90 + 51 – 0.48 (Issue 8) - 0.37(Issue5)	140.20
Total assets	741.60
Equity and liabilities	
Share capital	100.00
Share premium	20.00
Revaluation surplus(W4b)	14.49
Retained profits (W4a)	141.50
Non-controlling interests (W9)	28.32
Non-current liabilities (10 + 5 + 1.11(Issue 5) + 0.27 (Issue 8) -1.5(W7) + 0.5 (Issue 4)	17.40
Current liabilities (188 + 230 + 0.9 (Issue 3) + 0.37(Issue 5) + 0.5(Issue 6)+ 0.12(W6))	419.89
Total Equity and liabilities	741.60

Mascot Group
Consolidated Statement of Profit and Loss and Other Comprehensive Income
for the year ended 31 December 2014

	€m
Revenue (448 + 420 – 130(W5) – 0.9(Issue 3)	737.10
Cost of sales (269 + 294 – 130(W5) + 3.5(W5) + 1(W8) + 3(Issue 10) + 1(Issue 1) + 0.34(Issue 5) + 1.5(Issue 6) – 1.5(W7) + 4.7(Issue 7) + 0.8(W7)	(447.34)
Distribution costs and administrative expenses (62 + 29 + 9(Issue 1)	(100.00)
Finance costs (5 + 8 + 0.14(Issue 5) + 0.75 (Issue 8) + 0.12(W6)	(14.01)
Share of profit of associate (15 x 25%)	3.75
Profit before tax	178.92
Income tax expense (33 + 27)	(60.00)
Profit for the year	119.50
Other comprehensive income that will not be reclassified as profit or loss:	
Gain on revaluation of property (3 + 1)	4.00
Share of OCI of associate (1 X 25%)	0.25
Other comprehensive income for the year	4.25
Total comprehensive income for the year	**123.75**