CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

ADVANCED CORPORATE REPORTING

PROFESSIONAL 2 EXAMINATION - APRIL 2016

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. The pass mark required is 50% in total over the whole 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

You are a CPA who, after training in the public sector, decided on a fresh challenge and joined Patton Savage Pitman (PSP), a large accounting practice. While work has been interesting and rewarding, there has been a large amount of travel which has impacted upon your personal life. An opportunity has arisen for you to be seconded to WTM Plc (WTM), an Irish listed manufacturing company producing wind turbines.

WTM's Finance Director, John Agnew, interviews you and a number of other potential secondees in the board room at PSP. He informs you it is a two-month secondment to assist with the preparation of the year end consolidated accounts. John states:

"We run a very tight ship, the bulk of the work will have been carried out already. We just need someone to tidy up, you know, dot the i's and cross the t's."

Impressed by your technical knowledge, John offers you the secondment, which you accept as, the premises are only a five-minute drive from your home. *"I may even be able to get home for lunch,"* you think, while shaking his hand.

Keen to impress, in advance of your start you carry out some research on WTM. Its business has grown substantially over the last number of years as the demand for renewable energy has grown. It primarily manufactures medium-sized turbines on a supply only basis. These turbines would typically be a single large turbine associated with a particular building, such as a leisure centre or hospital. In the past year, however, WTM has expanded into the supply and maintenance of large-scale wind turbines used in wind farms. These contracts are generally much larger than the contracts WTM has dealt with to date.

During the year WTM, purchased shares in Renew Ltd (Renew) a manufacturer of smaller wind turbines which are generally installed in private residences. WTM has also owned shares in Solar Flair Ltd (Solar Flair) for many years, another Irish company manufacturing solar panels for installation on the roofs of residential properties.

It is February 2016 and you arrive for your first day at WTM. The receptionist greets you and then tells you that John Agnew is out of the office today but has asked her to phone him on your arrival. She passes you the phone and John starts speaking, barely pausing for breath.

"Hello, sorry I could not be there to welcome you on board, but I'm afraid I have bigger fish to fry! Business has been going well, we are in the final stages of signing contracts for eight large-scale wind farms and that is just the start of it. Once these come online our profits will go through the roof. If you're looking for any investments buy some of our shares now while you can still afford them. Ha Ha, just joking.

If you could go on upstairs to the Financial Accounting office you'll meet Jimmy Smith. He carries out most of the day-to-day work, he is a good lad and will keep you right. Jimmy has the accounts almost complete they just need to be consolidated, I would do it myself but I'm just too busy at the moment and I have to admit it, I've lost touch a little with the latest IFRSs. Before he left, the Financial Controller mentioned we should value non-controlling interests at fair value at acquisition. Please use this method and write me out a note about what this actually means and what the alternative is.

We are pretty happy with the figures at present as we have just met the targets for executive bonuses so try and avoid any adjustments which would lower sales or profit! Ha Ha, just joking.

Make sure you keep a good note of any adjustments you do make. I'll be back in the office on Friday to review how you are getting on and I would like to have a chat with you about Celtic Wind plc. I know PSP are their registered auditors, you haven't been involved with them at all have you? Bit of inside knowledge wouldn't go amiss. Ha Ha, just joking.

Really looking forward to working with you, and you never know, if we get on well you might be offered a permanent position."

As you pass the phone back to the receptionist you can't help thinking, *"This tight ship might just have a few leaks."*

You go upstairs and meet Jimmy. He is very welcoming to you, explaining that Peter Jones, the Financial Controller left in late November 2015, having been offered a Financial Director position in an unrelated company. Since then Jimmy, a recently qualified accountant, has been responsible for all the day-to-day financial accounting function. He looks exhausted and when you ask how he is finding it he informs you he has been able to keep on top of it, but only by working 60-hour weeks. He is confident all the day-to-day transactions have been recorded correctly but admits the year-end and consolidation adjustments are beyond his level of expertise.

Jimmy gives you a copy of the latest draft financial statements (Appendix 1), a document detailing investments in other companies (Appendix 2) and a file full of current-year information.

From the file of current-year information you ascertain:

1. During the year, WTM purchased $6,000,000 of specialist raw materials from an American company. The purchase took place and was recognised in the financial statements on 1 September 2015 when the exchange rate was $1.10:€1.00. The supplier has provided WTM with 6 months interest-free credit. At the reporting date of 31 December 2015 the exchange rate was $1.05:€1.00. As at 31 December 2015, 60% of the materials purchased were still in inventory in WTM.

2. On 1 January 2015, WTM entered into a lease with LRUS in respect of specialised manufacturing equipment. The cash price for the machine was €1,300,000 and WTM agreed to make three annual payments of €400,000 in advance and one final payment of €200,000 at the end of the three year term.

   Under the terms of the lease, WTM will be responsible for maintaining the machine and has the option to buy the asset for a nominal amount at the end of the lease. The lease does not have a break clause. The expected life of the asset is three years after which it will have a nil residual value. The interest rate implicit in the lease is 10%.

   To date the only entries to record the lease have been to debit cost of sales and credit bank with the first annual payment.

3. WTM offers a warranty on a number of its smaller sized supply only turbines. WTM has therefore made a provision of €300,000 for warranty claims. This represents 2% of total gross margin on this class of sales for the year ended 31 December 2015. All turbines in this class are sold at a gross profit margin of 30%. In the past, 2% of these turbines have been validly returned during the warranty period. WTM provides a full refund on return of the faulty turbine, which is then scrapped. The warranty covers any problems that occur with the turbine in the first 6 months following sale, and sales have occurred evenly throughout the year.

4. During the year, WTM completed its first supply and maintain contract. The turbines were supplied and operational on 31 October 2015. The contract was for €23,000,000 and its terms included a provision that WTM maintains the turbines for a period of five years from the initial date of operation.

   If the turbines had been delivered on a supply and fit only contract they would have cost €20,000,000. The maintenance contract on a wind farm of this size would normally be €1,000,000 per annum. WTM has been paid in full for this contract and included the full £23,000,000 as revenue in the draft accounts for 31 December 2015.

5. Given the strong growth expected by WTM management is concerned about the possibility of key employees leaving. With this in mind, WTM introduced a share option scheme on 1 January 2014 for all employees at supervisor level and above. Five hundred employees were eligible for the scheme. Each employee is entitled to 1,000 options to purchase equity shares at €20 per share, the fair value of each option at 1 January 2014 was €5.30. The options vest on 31 December 2016 if the employees continue to work for WTM during the three-year period.

   At 31 December 2014, 495 of the staff were still employed and 480 were expected to be employed at the vesting date. WTM's share price on 31 December 2014 was €21.00 and the fair value of each option was €5.40.

   By 31 December 2015, 490 of the staff were still employed and 475 were expected to be employed at the vesting date. WTM's share price on 31 December 2015 was €22.00 and the fair value of each option was €5.50.

   No entries have ever been made to record the share option scheme in the accounts.

6. WTM's revaluation surplus relates to its main manufacturing property. The property is leased with 40 years remaining on the lease. On 31 December 2015, its carrying value was €80,000,000 with €2,000,000 of depreciation having been charged to cost of sales during the year. Due to falling property prices the fair value of the property at 31 December 2015 was judged to be €70,000,000.

NOTE: IMPACT ON TAXATION MAY BE IGNORED

REQUIREMENT:

(a) Prepare a memorandum which:

(i) Evaluates and analyses each of the items 1 to 6 on Page 2. Your evaluation and analysis should include justification, based on appropriate IFRS, for your recommended treatment as well as the relevant calculations of how this will impact the consolidated statement of financial position and the consolidated statement of profit or loss and other comprehensive income for the WTM Group for the year ended 31 December 2015.

(45 Marks)

(ii) Includes the consolidated Statement of Profit or Loss and Other Comprehensive Income and the consolidated Statement of Financial Position of the WTM Group for the year ended 31 December 2015 in accordance with relevant IFRS (showing all relevant workings).

(25 Marks)

(b) Draft the requested note to John Agnew illustrating the methods of calculating non-controlling interest allowed under IFRS. You should present an alternative calculation of goodwill at acquisition and assess, with justifications, which method you believe to be superior.

(10 Marks)

(c) Appraise the ethical issues arising in the case study, justifying why you consider these to be ethical issues and recommend appropriate steps to address them.

(10 Marks)

(d) Compare the differences between the cost and revaluation model for the measurement of property, plant and equipment.

(5 Marks)

(e) Share option schemes such as WTM's should be accounted for in line with IFRS 2 - *Share Based Payments*. Consider the underlying principles contained in IFRS 2 and how those principles comply with the Conceptual Framework for Financial Reporting.

(5 Marks)

[Total: 100 Marks]

APPENDIX 1:

Draft Statements of Profit or Loss and Other Comprehensive Income for the Year Ended 31 December 2015.

	WTM	**Renew**	**Solar Flair**
	€m	**€m**	**€m**
Revenue	248	110	97
Cost of sales	(80)	(62)	(48)
Gross profit	168	48	49
Selling and distribution expenses	(20)	(7)	(6)
Administrative expenses	(12)	(4)	(3)
Finance costs	(10)	(4)	(1)
Dividend income (Renew and Solar Flair)			
Profit before tax	126	33	39
Tax expense	(25)	(7)	(8)
Profit for the year	101	26	31
Total comprehensive income for the year	101	26	31

Draft Statements of Financial Position as at 31 December 2015.

	WTM €m	Renew €m	Solar Flair €m
ASSETS			
Non-current assets			
Property, plant and equipment	265	80	45
Intangible assets	15	4	2
Investment property	22	-	-
Investment in Renew	45	-	-
Investment in Solar Flair	8	-	-
	355	84	47
Current assets			
Inventories	110	34	28
Trade receivables	60	22	25
Prepayments	1	-	-
Cash	33	16	18
	204	72	71
Total assets	**559**	**156**	**118**
EQUITY and LIABILITIES			
Issued share capital 1€ ordinary shares	150	20	16
Share premium	8	0	0
Retained earnings	210	58	77
Revaluation surplus	6	4	3
Total equity	374	82	96
Non-current liabilities	156	62	18
Current liabilities	29	12	4
	185	74	22
Total Equity and Liabilities	**559**	**156**	**118**

Appendix 2:
Investments in other companies
Investment in Solar Flair

WTM purchased 4m ordinary shares in Solar Flair on 31 December 2010. At that date the equity and liabilities of Solar Flair were as follows:

	€m
• Issued share capital 1€ ordinary shares	16
• Retained earnings	18
• Revaluation surplus	1

During the year, Solar Flair sold goods to WTM for €1,500,000. These goods had cost Solar Flair €1,000,000, WTM had €1,200,000 (at cost to WTM) in inventory at the reporting date. WTM's accounts payable include an amount of €1,000,000 owing to Solar Flair. (This agreed with the balance in Solar Flair's books).

Investment in Renew

WTM acquired 11m ordinary shares in Renew on 31 December 2014 for €45,000,000, the fair value of the Non-controlling interest at this date was €30,000,000. It is group policy to value non-controlling interest at fair value at the date of acquisition.

At the date of acquisition the fair value of net assets acquired was the same as the book value with the following exceptions:

- The fair value of the plant and equipment was €2,000,000 in excess of the book value. This plant and equipment had an estimated remaining useful life of eight years, a full years depreciation is charged in the year of acquisition, none in the year of disposal.
- The fair value of the inventories was €1,500,000 higher than the book value. All these inventories were sold by 31 December 2015.

On acquisition, WTM identified an intangible asset that Renew developed internally but which met the recognition criteria of IAS 38 *Intangible Assets*. This intangible asset was valued at €500,000 at acquisition and is expected to generate economic benefits until 31 December 2016.

An impairment review was carried out at 31 December 2015 and it was decided that goodwill on acquisition of Renew was impaired by 50%.

During the year, Renew sold goods to WTM for €4,000,000 at a mark-up of 25%. At 31 December 2015, WTM had a quarter of these goods in inventory. As a result of these sales WTM's accounts payable include an amount of €1,500,000 owing to Renew (this agreed with the balance in Renew's books).

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

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

ADVANCED CORPORATE REPORTNG

PROFESSIONAL 2 EXAMINATION - APRIL 2016

SOLUTION 1

(a) (i)

Memorandum: Confidential

To: John Agnew, WTM Finance Director

From: CPA

Subject: WTM Group: Explanation and analysis of adjustments required for year end and consolidation.

Date: February 2016 1 mark

John
Further to our telephone conversation, I have set out below the adjustments required to the consolidated financial statements, together with a justification for each based on the relevant IFRS.

1. WTM purchase of raw materials from American company

As WTM agreed the value of the contract in US Dollars rather than their functional currency, the Euro, WTM are subject to exchange rate risks. Any movement in the Euro to US Dollar exchange rate between the transaction date and the date the contract is settled will give rise to either an exchange gain or loss.

Guidance on how to account for these exchange gains and losses is given in IAS 21 The Effects of Changes in Foreign Exchange Rates.

The contract will initially be recorded in Euro's at the spot rate on 1st September 2015, the date of the contract. As no payment has been made to the American supplier by 31st December 2015 the contract must be translated at the 31st December spot rate to calculate the gain or loss on foreign exchange, as illustrated below:

Date	**Transaction currency amount $m**	**Exchange rate**	**Functional currency amount €m**
01/09/15	6	1.10	5.45
31/12/15	6	1.05	5.71
Exchange loss			0.26

The exchange loss of €0.26m will increase the accounts payable balance of the Statement of Financial Position and be charged as an expense in the Statement of Profit or Loss and Other Comprehensive Income.

As per IAS 2 *Inventories*, the goods still held in inventory at 31st December 2015 must be valued at the lower of their cost and net realisable value. Assuming no damage or impairment has occurred regarding these goods, they should be recorded at the spot rate on the date of purchase, as this is the cost to WTM. There will therefore be no change to the inventory value. The exchange loss is a finance cost. The adjustment required in the financial statements is therefore:

	Dr €m	Cr €m
Administration expenses	0.26	
Accounts payable		0.26

(6 marks)

2. **Lease of specialised manufacturing equipment with LRUS**

The lease with LRUS must be treated as a finance lease as it meets the following indicators of a finance lease as per IAS 17 *Leases*:

- The term of the lease is for the majority of the economic life of the asset. In this instance the lease term is for three years and the expected life of the manufacturing equipment is also three years.

- At the inception of the lease the present value of the minimum lease payments amounts to substantially all of the fair value of the leased asset. In this instance, at a discount rate of 10% the present value of the lease payments is just below the fair value of the leased asset, as illustrated below:

	Year 0	**Year 1**	**Year 2**	**Year 3**
	€m	**€m**	**€m**	**€m**
Payment	0.400	0.400	0.400	0.200
Discount factor 10%	1	0.909	0.826	0.751
	0.400	0.364	0.330	0.150
Total present value				1.244

(As the present value of the lease payments is less than the fair value of the leased asset we use recognise the fair value as an asset)

- Additionally WTM has the option to buy the machinery for a nominal amount at the end of the lease. While this will not be significantly below the fair value at the end of the lease, which is forecast to be zero, the expected transfer of ownership is another indicator of a finance lease.

  The substance of this transaction is therefore that WTM has borrowed a sum of money from LRUS to purchase the machinery. Although legal title will not pass to WTM until it exercises its option to buy the machinery at the end of the lease, WTM has acquired and assets as defined by the Conceptual Framework for Financial Reporting.

- WTM has control over the machinery and it is probable that economic benefits will flow to WTM from the machinery.

  WTM must therefore recognise the machinery as an asset and recognise a liability equal to the fair value of the machinery. The finance charge will then be allocated each period ensuring a constant periodic rate of interest, in this instance 10%. Depreciation must be charged on the machinery in accordance with IAS 16 Property, Plant and Equipment.

The calculation of the annual interest charges over the term of the lease is set out below:

Year	**Bal b/f**	**Repay**	**Bal for int**	**Interest**	**Closing bal**	**Current liabil**	**Non current liabil**
	€m	**€m**	**€m**	**€m**	**€m**	**€m**	**€m**
31/12/15	1.244	0.4	0.844	0.084	0.928	0.4	0.528
31/12/16	0.928	0.4	0.528	0.053	0.581	0.581	
31/12/17	0.581	0.4	0.181	0.018	0.199		
31/12/17	0.199	0.2	0				

Note: *For the purposes of the question only the figures for 31/12/15 are required. It is good practice to calculate all figures for the duration of the lease however as these may be left on file and used to prepare journal entries in subsequent years.*

The depreciation charge will be over the shorter of the lease term and the useful life of the machinery, in this case three years.

	€m
Cost	1.244
Depreciation	0.415
Net book value 31/12/15	0.829

The adjustments required to the financial statements are therefore:

	Dr	Cr
	€m	**€m**
Property, plant and equipment	1.244	
Finance lease liabilities <1 year		0.4
Finance lease liabilities >1 year		0.844
(Initial recording of lease)		
Finance lease liabilities >1year	0.4	
Cost of sales		0.4
(Transfer of first lease payment from cost of sales)		
Finance costs	0.084	
Finance lease liabilities >1 year		0.084
(Finance lease interest charge)		
Depreciation	0.415	
Property, plant and equipment		0.415
(Depreciation on leased asset)		

(12 marks)

3. Warranty on supply only wind turbines

Warranty provisions are governed by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The potential warranty claims meet the criteria to be recognised as a provision:

- A present obligation as a result of a past event.
- A probable outflow of economic benefits.
- It may be reliably measured.

However the current calculation is not consistent with IAS 37. IAS 37 requires large populations of events, such as warranties, to be measured at probability weighted value. The current calculation correctly uses the percentage of goods historically returned of 2% as the probability weighting. However it applies this weighting to the annual gross margin, despite the warranty only covering problems arising in the first 6 months after purchase.

Additionally, the current calculation provides for 2% of gross margin, whereas customers are refunded the full selling price. As the goods are scrapped it is assumed WTM has no potential for re-imbursement from its supplier regarding the faulty goods.

A calculation of the corrected warranty provision is set out below:

- 2% of annual gross margin is €300,000 therefore 100% of annual gross margin must be €15,000,000.

	%age	Annual sales	Products under warranty at 31/12/15	Percentage expected to be returned	Warranty provision
		€m	€m	€m	€m
Gross margin	30%	15			
Selling price	100%	50	25	2%	0.5

The warranty provision should therefore be increased to €0.5m. As the provision is expected to be used in the next 6 months no discounting is required.

The adjustment required to the financial statements is therefore:

	Dr	Cr
	€m	€m
Warranty provision – Cost of sales SoPoL	0.2	
Warranty provision – Current liabilities		0.2

(6 marks)

4. **Supply and maintain contract**

Revenue is governed by IAS 18 *Revenue*. This would be considered a multiple element transaction, as such the recognition of revenue criteria should be applied separately to each element of the transaction. I.e. The supply of the turbines and the maintenance of the turbines.

Supply of turbines

Revenue from the sale of turbines is recognised when all of the conditions below are satisfied:

- Seller has transferred to the buyer all of the significant risks and rewards of ownership.
- Seller retains neither continuing managerial involvement with the goods nor effective control over them.
- The amount of revenue can be reliably measured.
- It is probable that economic benefits associated with the transaction will flow to the seller.
- The costs incurred can be reliably measured.

As all of these conditions are satisfied WTM may recognise all the revenue from the sale of the turbines.

Maintenance of turbines

The maintenance of the turbines would be a rendering of services. The revenue from this maintenance contract may only be recognised once it can be estimated reliably, which it can in this case. The amount of revenue to be recognised should be based on the stage of completion of the contract, in this case the two out of the sixty months of the contract have been completed.

When considering how to split the revenue between the supply of turbines and the maintenance we view the €2m difference between the combined contract and what the sum of the individual contracts would cost as a discount and apply that discount to each individual component of the contract on pro-rata basis based on its individual fair value.

As we have received full payment for the maintenance contract, but it still has 58 months still to run, we must record the payment received in advance as deferred income, splitting it between amounts to be received in less than one year and greater than one year.

The relevant calculations and adjustments to the financial statements are below:

	€m
Fair value of turbines (20/25) * 23	18.4
Fair value of maintenance contract (5/25) * 23	4.6
	23

Revenue recognised ye 31/12/2015	€m
Turbines	18.4
Maintenance contract 4.6 * 2/60	0.15
	18.55
Deferred income < 1 year	0.92
Deferred income > 1 year	3.53

	Dr	Cr
	€m	€m
Revenue (23-18.55)	4.45	
Deferred income < 1 year		0.92
Deferred income > 1 year		3.53

(6 marks)

5. **Share option scheme**

The share option scheme would be governed by IFRS 2 Share Based Payments, under this IFRS all entities are required to recognise share based payments in their financial statements, WTM should therefore have recognised this in their 2014 financial statements also. The consequences of failing to report the share option scheme in the 2014 financial statements will be determined by IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The share option scheme is an equity settled transaction, WTM is receiving services from the staff in return for the granting of the share options. They must therefore measure the fair value of the share options and charge this expected cost through the Statement of Profit or Loss.

The failure to recognise the share option scheme in the 2014 financial statements is a prior period error. According to IAS 8 material prior period errors should be corrected retrospectively as soon as discovered by restating the comparatives for the prior periods presented. WTM must therefore restate the comparatives, which will impact the retained earnings brought forward.

The relevant calculations and adjustments to the financial statements are shown below:

Year end	**Num opitons**	**Expect num employ**	**FV of option**	**Expect cost**	**Cum charge**	**Recog to date**	**Annual charge**
31/12/14	1,000	480	5.30	2,544,000	848,000	0	848,000
31/12/15	1,000	475	5.30	2,517,500	1,678,333	848,000	830,333

	Dr	**Cr**
	€m	**€m**
Cost of sales	0.83	
Retained earnings	0.85	
Share option reserve		1.68

Note: This assumes staff on the share option scheme are operational with their wages charged to cost of sales, if staff on the share option scheme are administrative with their wages charged to Admin expenses the share option scheme cost should also be charged to Administrative expenses.

(8 marks)

6. **Revaluation of property**

According to IAS 16 *Property, Plant and Equipment* all purchased items of property, plant and equipment are initially recognised at cost, after this an entity may choose to apply the cost model, where PPE is carried at cost less accumulated depreciation, or the revaluation model, where an item of PPE is carried at re-valued amount.

If the revaluation model is used the entire class of PPE to which that asset belongs must be re-valued. The frequency of revaluation depends on the movements in the fair value of the items being re-valued, but where there are significant movements in fair value annual revaluations may be required.

In this instance there has been a significant movement in fair value, the manufacturing property must therefore be re-valued to €70m. The decrease must reduce the previous re-valuation surplus related to the manufacturing property to zero, with any remaining decrease recognised immediately in the Statement of Profit or Loss for the period.

The relevant calculations and adjustments to the financial statements are shown below:

	31/12/15
	€m
Opening NBV	82
Depreciation	2
Carrying value	80
Revaluation	70
Revaluation loss	10

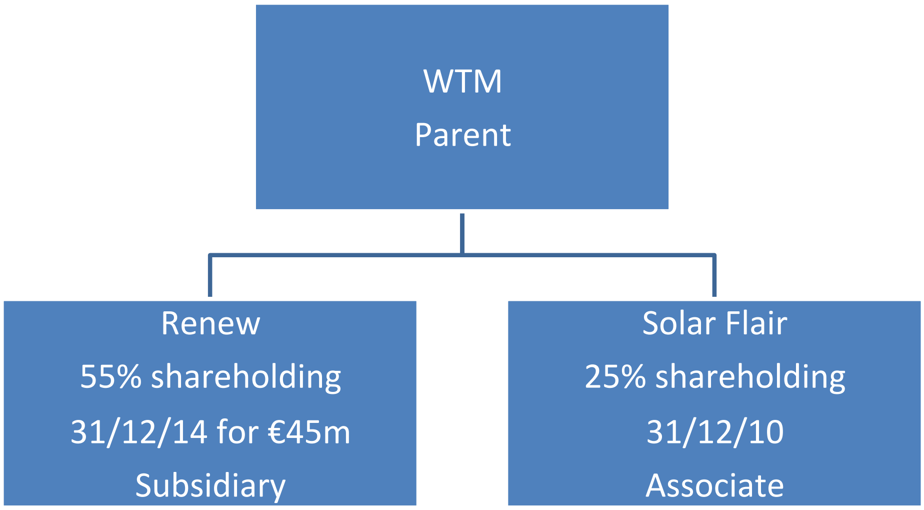
	Dr	**Cr**
	€m	**€m**
Revaluation surplus	6	
Revaluation of property plant and equipment SoPoL&OCI	4	
Property plant and equipment		10

(4 marks)

Format and presentation (2 marks)

(a) (ii)

1. Group structure



(1 mark)

2. Net assets of subsidiary

	Acquisition Date	**Reporting Date**
	€m	**€m**
Share capital	20	20
Retained earnings	32	58
Other reserves	4	4
Fair value adjustments		
PPE	2	2
Depreciation adjustment		(0.25)
Inventory	1.5	0
Intangible asset	0.5	0.5
Amortisation of intangible		(0.25)
Contingent liability		
Provision for unrealised profit adjustment		(0.2)
	60	83.8
Post-acquisition profit	23.8	

3. Goodwill

	€m
Fair value of WTM's investment	45
Value of non-controlling interest at acquisition	30
Fair value of sub's net assets at acquisition (W2)	(60)
Goodwill at acquisition	15
Impairment	(7.5)
Goodwill at reporting date	7.5

4. Non-controlling interests

	€m
Value of NCI at acquisition (per goodwill calc)	30
NCI% x post-acq reserves 23.8 X 45%	10.71
NCI% x impairment 7.5 X 45%	(3.38)
CI at reporting date	37.33

5. Depreciation adjustment

	€m
Fair value adjustment	2
Annual depreciation adjustment	0.25
Depreciation adjustment since acquisition	0.25

6. Intangible amortisation adjustment

	€m
Intangible value	0.5
Annual amortisation	0.25

7. Provision for unrealised profit adjustment

		€m Total	€m Remain in inv
Selling price	125%	4	1
Profit	25%	0.8	0.2
Cost price	100%	3.2	0.8

- Eliminate intercompany sales.
- Reduce closing inventory and retained earnings by unrealised profit.
- Clear intercompany balances.

(12 marks)

8. Investment in associate

	€m
Cost	8
Share of post acquisition profits and reserves ((77+3)-(18+1))*25%	15.25
	23.25

9. Provision for unrealised profit – associate

		€m Total	€m Remain in inv
Selling price	150%	1.5	1.2
Profit	50%	0.5	0.4
Cost price	100%	1.0	0.8

- Provision for unrealised profit = €0.4*25% = €0.1m
- Reduce closing inventory and retained earnings by unrealised profit
- Intercompany balances between parent and associate are not eliminated

10. Share of profit of associate

	€m
31 * 25%	7.75
Less unrealised profit	(0.10)
	7.65

(6 marks)

	WTM	Exchange loss	Lease	Warranty	Maint contract	Share option	Property reval	WTM	Renew	Gwill	Gwill Impair	NCI Post Acq res	Depreciation	Amor Intang	PUP	Inventory	Inter co sales	Assoc	Consol
Revenue	248.000				- 4.450			243.550	110.000								- 4.000		349.550
Cost of sales	- 80.000		- 0.015	- 0.200		- 0.830		- 81.045	- 62.000				- 0.250	- 0.250	- 0.200		4.000		- 139.745
Gross profit	168.000	-	- 0.015	- 0.200	- 4.450	- 0.830	-	162.505	48.000	-	-		- 0.250	- 0.250	- 0.200	-	-	-	209.805
Selling and distribution expenses	- 20.000							- 20.000	- 7.000										- 27.000
Administrative expenses	- 12.000	- 0.260						- 12.260	- 4.000										- 16.260
Finance costs	- 10.000		- 0.084					- 10.084	- 4.000										- 14.084
Share of profit of associate								-										7.650	7.650
Dividend income (Renew and Solar Flair)								-											-
Profit before tax	126.000	- 0.260	- 0.099	- 0.200	- 4.450	- 0.830	-	120.161	33.000	-	-		- 0.250	- 0.250	- 0.200	-	-	7.650	160.111
Tax expense	- 25.000							- 25.000	- 7.000										- 32.000
Profit for the year	101.000	- 0.260	- 0.099	- 0.200	- 4.450	- 0.830	-	95.161	26.000	-	-		- 0.250	- 0.250	- 0.200	-	-	7.650	128.111
Other comprehensive income							- 4.000	- 4.000											- 4.000
Revaluation of property plant and equipment								-											-
Net changes in fair value of available for sale financial assets								-											-
Re-measurement of net defined benefit liability								-											-
Total comprehensive income for the year	101.000	- 0.260	- 0.099	- 0.200	- 4.450	- 0.830	- 4.000	91.161	26.000	-	-		- 0.250	- 0.250	- 0.200	-	-	7.650	124.111

ASSETS																			-
Non-current assets																			-
Property, plant and equipment	265.000		0.829				- 10.000	255.829	80.000	2.000			- 0.250						337.579
Goodwill								-		15.000	- 7.500								7.500
Intangible assets	15.000							15.000	4.000	0.500				- 0.250					19.250
Investment property	22.000							22.000											22.000
Investment in Renew	45.000							45.000		- 45.000									-
Investment in Solar Flair	8.000							8.000										15.250	23.250
	355.000	-	0.829	-	-	-	- 10.000	345.829	84.000	- 27.500	- 7.500		- 0.250	- 0.250	-	-	-	15.250	409.579
Current assets																			
Inventories	110.000							110.000	34.000	1.500					- 0.200	- 1.500		- 0.100	143.700
Trade receivables	60.000							60.000	22.000								- 1.500		80.500
Prepayments	1.000							1.000											1.000
Cash	33.000							33.000	16.000										49.000
Assets held for sale								-											-
	204.000	-	-	-	-	-	-	204.000	72.000	1.500	-		-	-	- 0.200	- 1.500	- 1.500	- 0.100	274.200
Total assets	559.000	-	0.829	-	-	-	- 10.000	549.829	156.000	- 26.000	- 7.500		- 0.250	- 0.250	- 0.200	- 1.500	- 1.500	15.150	683.779
EQUITY and LIABILITIES																			
Issued share capital 1€ ordinary shares	150.000							150.000	20.000	- 20.000									150.000
Share premium	8.000							8.000	-										8.000
Retained earnings	210.000	- 0.260	- 0.099	- 0.200	- 4.450	- 1.680	- 4.000	199.311	58.000	- 32.000	- 4.120	- 10.710	- 0.250	- 0.250	- 0.200	- 1.500		15.150	223.431
Share option reserve						1.680		1.680											1.680
Revaluation surplus	6.000						- 6.000	-	4.000	- 4.000									-
Total equity	374.000	- 0.260	- 0.099	- 0.200	- 4.450	-	- 10.000	358.991	82.000	- 56.000	- 4.120		- 0.250	- 0.250	- 0.200	- 1.500	-	15.150	383.111
Non-controlling interests								-		30.000	- 3.380	10.710							37.330
Non-current liabilities	156.000		0.528		3.530			160.058	62.000										222.058
Current liabilities	29.000	0.260	0.400	0.200	0.920			30.780	12.000								- 1.500		41.280
	185.000	0.260	0.928	0.200	4.450	-	-	190.838	74.000	30.000	- 3.380		-	-	-	-	- 1.500	-	300.668
Total Equity and Liabilities	559.000	-	0.829	-	-	-	- 10.000	549.829	156.000	- 26.000	- 7.500		- 0.250	- 0.250	- 0.200	- 1.500	- 1.500	15.150	683.779

6marks

WTM Group
Consolidated Statement of Profit or Loss and Other Comprehensive Income
for the Year Ended 31/12/15

	€m
Revenue	349.550
Cost of sales	(139.745)
Gross profit	209.805
Selling and distribution expenses	(27.000)
Administrative expenses	(16.260)
Finance costs	(14.084)
Share of profit of associate	7.650
Profit before tax	160.111
Tax expense	(32.000)
Profit for the year	128.111
Other comprehensive income	(4.000)
Total comprehensive income for the year	124.111

WTM Group
Consolidated Statement of Financial Position as at 31/12/15

	€m
ASSETS	
Non-current assets	
Property, plant and equipment	337.579
Goodwill	7.500
Intangible assets	19.250
Investment property	22.000
Investment in Solar Flair	23.250
	409.579
Current assets	
Inventories	143.700
Trade receivables	80.500
Prepayments	1.000
Cash	49.000
	274.200
Total assets	**683.779**
EQUITY and LIABILITIES	
Issued share capital 1€ ordinary shares	150.000
Share premium	8.000
Retained earnings	223.431
Share option reserve	1.68
Revaluation surplus	0
Total equity	383.111
Non-controlling interests	37.330
Non-current liabilities	222.058
Current liabilities	41.280
	300.668
Total Equity and Liabilities	**683.779**

(b) Allowable calculations of Goodwill under IFRS

Under IFRS 3 *Business Combinations* WTM has two options when valuing the non-controlling interests in Renew. The calculation of goodwill at the date of acquisition will depend on which of these methods has been used. The methods available are:

- Full (fair value) method
- Partial (proportionate share) method

Full (fair value) method
Under the full method the non-controlling interest in Renew is valued at the fair value at date of acquisition, i.e. its value including goodwill. The goodwill on acquisition shown in WTM's consolidated financial statements will be 100% of Renew's goodwill.

Partial (proportionate share) method
Under the partial method, the non-controlling interest in Renew does not include its proportion of goodwill. The goodwill on acquisition shown in WTM's consolidated financial statements will therefore only be WTM's share of Renew's goodwill.

The calculations of goodwill under the full and partial methods are shown below:

	Full method	Partial method
	€m	€m
Purchase consideration	45	45
Non-controlling interest	30	27
	75	72
Fair value of identifiable net assets acquired		
Ordinary share capital	20	20
Pre-acquisition retained earnings	32	32
Other reserves	4	4
Fair value adjustment	4	4
	60	60
Goodwill on acquisition	15	12

The difference between goodwill under the full method and under the partial method represents the goodwill of Renew at the date of acquisition attributable to the non-controlling interest.

IFRS 3 permits either the full or partial method, the method may be decided on a transaction by transaction basis. In instances such as this, where and accurate fair value of the non-controlling interest at acquisition is available, I would recommend using the full method.

The reasons for this are as follows:

A basic principle of consolidation under IFRS 10 is that although WTM owns 55% of Renew's share capital, it must consolidate 100% of Renew's assets and liabilities, as it controls all of them.

If the partial method is used, only the goodwill attributable to WTM is included in the consolidated financial statements, in this case €12m. This is despite goodwill meeting the definition of an asset, as set out in the Conceptual Framework for Financial Reporting. The partial method therefore leads to conflicting treatment of assets in the consolidated financial statements.

The full method brings 100% of Renew's goodwill into the consolidated financial statements, in this case €15m. This is consistent with the treatment of Renew's other assets and liabilities.

The full method is also consistent with USGAAP which does not allow the partial method.

The consequences of the full method include:
- An increase in the reported net assets on the Statement of Financial Position.
- Any impairment of goodwill will be greater.
- Goodwill impairment testing will be simpler, as there is no need to gross up recorded goodwill for the implied value of goodwill attributable to the non-controlling interest.

(10 marks)

(c) There are a number of ethical issues in the case, mostly around the behaviour of the Finance Director, John Agnew.

1. **Recommending the purchase of shares in WTM**
John is sharing company information which, if it were to be made public, would have a significant effect on the share price of WTM. If acted upon this would amount to insider trading which would breach the requirements of the Companies Act.
Aside from the legal implications this is also in breach of ethical principles to which all accountants should adhere. This revelation could be considered a breach of both the principles of Integrity and Confidentiality.
Under no circumstances should shares in WTM be purchased based on this information.

2. **Executive bonuse**s
John has requested sales and profit figures are not altered in case it impacts on executive bonuses. Again this request is clearly a breach of ethical principles, this time Integrity and Professional Behaviour. Were the request to be acted on it would necessitate breaking the ethical principles of Objectivity and Professional Competence and Due Care. Manipulating the sales and profit figures would also be at odds with the qualitative characteristic of faithful representation as set out in the Conceptual Framework. Adjustments to the financial statements should be decided by reference to the appropriate accounting standards only.

3. **Celtic Wind Plc**
By requesting confidential information on Celtic Wind John Agnew is asking for the ethical principle of Confidentiality to be broken. Under no circumstances should any information be divulged.

4. **Offer of permanent position**
There is a suggestion that acquiescing to John's requests could lead to a permanent position in the company. This is clearly a breach of the principle of Professional Competence and Due Care. John should use professional competence and recruit only the most suitably qualified for the position in line with relevant employment law.

5. **Jimmy Smith responsibility and working hours**
The company is behaving unethically towards Jimmy Smith. There is no indication that the Financial Controller is going to be replaced. This leaves Jimmy Smith, an under-qualified member of staff with no option but to work significantly longer than his contracted hours. Again this breaks the principle of Professional Behaviour and Due Care.
John Agnew is clearly aware of the ethical dilemmas he is presenting and seems to feel adding, "Ha Ha. Only joking!" absolves him from his actions. This quite clearly is not the case. As a secondee it would be advisable to draw up a report detailing the issues identified above and present it to your Manager / Partner within PSP.

(5 marks)

(d) According to IAS 16 *Property, Plant and Equipment* all purchased items of property, plant and equipment are initially recognised at cost, after this an entity may choose to apply the cost model, where PPE is carried at cost less accumulated depreciation, or the revaluation model, where an item of PPE is carried at re-valued amount.

If the revaluation model is used the entire class of PPE to which that asset belongs must be re-valued. The frequency of revaluation depends on the movements in the fair value of the items being re-valued, but where there are significant movements in fair value annual revaluations may be required.

The cost model is more objective as a cost is definite but is providing out of date information. The revaluation model could be considered more subjective as it relies on expert valuers to provide reliable measures of fair value. These measures will be more up to date but may lead to large revaluation gains and losses in the event of a booming property market followed by a crash, as is the case here. The cost model will be cheaper to apply as no expert opinions are required.

Allowing two models leads to a lack of comparability across reporting entities, not just in the Statement of Financial Position but also in the Statement of Profit or Loss as the depreciation charges will be adjusted for revaluation.

(5 marks)

(e) WTM's share option scheme is an equity settled share based payment transaction. WTM receives services from its employees as consideration for equity shares in WTM. As the fair value of the services received cannot be determined, WTM must account for the share option scheme at the fair value at the grant date of the options.

The scheme has a three year vesting period during which employees must remain with WTM if they are to exercise their options. As the vesting period is longer than the current financial period the expense is spread over the vesting period until the options vest.

The costs of providing the share option scheme are recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable. The cost not paid is recognised as a share option reserve, (accruals concept).

The Conceptual Framework concentrates on ensuring the Statement of Financial Position is providing a true and fair view before considering the income and expenses. IFRS 2 ensures the costs accrued regarding the share option scheme are properly recorded as a share option reserve on the Statement of Financial Position at the year end, thereby complying with the Conceptual Framework.

(5 marks)

[Total: 100 Marks]