CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

ADVANCED CORPORATE REPORTING

PROFESSIONAL 2 EXAMINATION - APRIL 2017

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

ADVANCED CORPORATE REPORTNG

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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

Colindale Plc (Colindale) is an Irish listed company which prepares financial statements in accordance with International Financial Reporting Standards (IFRS) up to 31 December each year. The company was founded in 2001 and operates in the logistics and supply chain management sector. Three years ago, the company began the manufacture of an innovative and environmentally friendly composite pallet, the PA1. It has been extensively and independently tested by leading institutions and shown to outperform comparable products and industry standards. Over the last three years, the company has invested significantly in research and development related to pallet manufacturing technologies, pallet design, and pallet supply chain logistics. Compared to traditional wooden pallets, the PA1 is highly durable, with relatively low maintenance costs. To date, the company had focused its operations primarily in Irish, German and French markets, although, the newly appointed managing director, Ashley Downes, has indicated that there is potential for the PA1 to penetrate the North American market. On 1 January 2016, Colindale acquired 80% of the equity interests of Sunningdale Limited (Sunningdale). On the same date, Colindale also acquired 60% of the equity interests of Yardale Limited (Yardale). Both of the acquired companies operate in the design and delivery of supply chain logistics.

You are Peter Kearns, a Certified Public Accountant (CPA) and have recently been appointed as the deputy financial controller in Colindale. You report directly to the finance director, Maria Bigoni. Just last week, you received the following email from Maria.

Good morning Peter,

I hope you are settling into your new role as deputy financial controller. As I mentioned at the interview, working in Colindale can be stressful at certain times of the year but, as a newly qualified CPA, and with the experience you gained in the technology sector, I think you will be well able to handle the pressure. As you are aware, I have to present some financial information at the board meeting scheduled in two days' time and I need your help. Paul Jones, the previous holder of your post, prepared some briefing notes (see below) regarding the preparation of the consolidated financial statements of the Colindale Group for the year ended 31 December 2016. As per IFRS3 - Business Combinations, I really want to use the 'partial goodwill' method to account for the Sunningdale acquisition and the 'full goodwill' method to account for the Yardale acquisition. From memory, I don't think it is mandatory to use one method, so there should be no problem. Please refer to Paul's briefing notes for further information in relation to these acquisitions.

As I mentioned to you yesterday, over coffee, Ashley regards leasing as an important method of financing the company. However, and you are probably more up to date with the existing accounting requirements than me, the current accounting standard has some significant deficiencies and no longer meets the needs of users of financial statements. On 1 January 2016, we entered into a sale and finance leaseback transaction with our bank. The arrangement involved the sale, at fair value, of a building for €8 million. The book value of the building in the financial statements at that date was €6 million. More details on this are provided in the briefing notes (see Note 3 below). I know that Ashley is particularly concerned that showing the lease as a finance lease could be detrimental to any loan applications that we might make over the next twelve months. Between you and me, we need to keep him happy: my year-end bonus could be in jeopardy if we get this area wrong. In the medium term, I am worried about the implications of the introduction of IFRS16 - Leases, particularly the effects on the statement of financial position, statement of profit and loss and other comprehensive income, and our key financial ratios. Surely our gearing ratio will be higher? Maybe we can get round the problem of including leases on the statement of financial position by classifying some of them as short-term (i.e. less than twelve months)? Peter, I should be grateful if you could give me some advice on this issue.

I don't know whether you heard the news that Paradox Limited (Paradox), an important customer of ours, is having some liquidity problems. I think it is a case of not being able to manage their working capital cycle effectively. I know the financial controller of Paradox well, and he has mentioned that they have approached

Randal Plc (Randal) for credit. Of course, if they are successful, we should have no problems in getting paid. Today, I have received a request from Randal asking for a credit reference for Paradox. I think if you check their credit history you will find they were good payers. Do you think I should mention anything about the liquidity issue?

Finally, on 1 March 2016, Paul Jones arranged for us to purchase a customer list from the liquidator of one of our competitors. Unfortunately, simplicity and clarity of communication was not one of his strongest attributes. The final price paid was €21 million, which has been included in the draft financial statements (Appendix 1), and this was based on the list having a useful life of three years. Paul led a team from our marketing department who have been working to extend the life of the list by adding additional contacts obtained from the various marketing campaigns (emails distributions, social media and website enquires). The allocated salary cost of the marketing team is estimated at around €250,000. At 30 December 2016, I commissioned a report from Survey Limited (Survey) on the value of the customer list. This company is renowned for their expertise in brand valuations. I can tell you that they have valued the customer list at €25 million, with an estimated useful life of five years. Paul was keen that we measured intangibles at historic cost. However, I, am concerned (and I think the other directors agree) that the statement of financial position does not reflect the true value of our business and we should consider changing or at least reviewing, our policy in respect of intangible assets. One issue that you might want to bear in mind is that our marketing director owns a 55% stake in the equity of Survey.

Best wishes
Maria

After reflecting on the email from Maria, you begin to wonder why your predecessor had stayed in the job for six months. While you have not been in the job for long, you are beginning to realise that the organisational culture is one of command and control and there is little opportunity, or encouragement, to provide alternative opinions. While you would be reluctant to say anything to Maria or Ashley, a friend of yours who works for Survey, mentioned that staff were instructed to provide an optimistic valuation of the updated customer list.

On speaking to another member of Colindale's staff you were told, in confidence, that one of the directors has been taking decisions to benefit her outside business interests through financial arrangements with Colindale. All of the directors, of course, claim that their business interests are successful. You also found out that Colindale had opened a waste recycling facility on 1 January 2011. It is your understanding that during the construction of the facility environmental damage was caused. Apparently, Colindale is required to carry out a decontamination of the land at the end of the facility's ten-year life. On further investigation, you ascertain that the cost of the decontamination process was estimated at 1 January 2011 to be €15 million in ten years' time (i.e., on 31 December 2020). As at 31 December 2015, a provision of €9.3 million was included in the statement of financial position and this had been calculated correctly using a discount rate of 10% per annum. You have no idea why nothing on this transaction has been included in the briefing notes left by your predecessor, Paul Jones. No accounting entries have been made for the year-ended 31 December 2016.

You switch off your computer and begin to scan the briefing notes (see below) left by Paul Jones. While you have only been working at Colindale for a couple of months, you have noticed that staff are expected to work long hours to ensure all reporting deadlines are met. You reflect on the times when you were studying for your professional examinations, and remember the advice which you were given by your financial accounting tutor – 'accounting is about communication, sometimes you have to use your professional judgement and make assumptions when preparing the financial statements'. You quickly refocus your mind and begin to work on the briefing issues (see below); it is going to be a long evening.

Briefing notes:

1. The following information is relevant to the preparation of the group financial statements of the Colindale Group:

Date of acquisition	Holding acquired	Retained earnings	Purchase consideration
	%	€m	€m
Sunningdale: 1 January 2016	80	225	2,050
Yardale: 1 January 2016	60	541	1,353

Sunningdale and Yardale have not issued any share capital since the acquisition of shareholdings by Colindale. The consideration for the acquisition of Sunningdale consisted of €1,845 million cash together with the transfer of land with a fair value of €205 million. The actual book value of the land at the date of acquisition amounted to €180 million. At the reporting date (31 December 2016), the land was still included in the non-current assets of Colindale and the sales proceeds had been credited to the statement of profit and loss and other comprehensive income (SPLOCI). The fair value of Sunningdale's identifiable net assets at the date of acquisition was €1,800 million and other reserves were €50 million at that date. Any excess in fair value is due to the land.

The consideration for the acquisition of Yardale comprised of €1,353 million cash. At acquisition, the fair value of non-controlling interest in Yardale was estimated at €680 million. In addition, the fair value of the identifiable net assets acquired at the date of acquisition was €1,591 million and other reserves were €55 million at the date. As with the Sunningdale acquisition, any excess in fair value is due to the land.

2. Both Sunningdale and Yardale were the subject of impairment tests at 31 December 2016. The directors estimate that the recoverable amount of Sunningdale was €3,200 million and Yardale was €1,914 million.

3. The building was leased back from the bank for a period of twenty years, which was effectively the majority of the asset's useful economic life. The lease rentals for the period of the lease are €710,000 payable annually in arrears. The interest implicit in the lease is 8% and the present value of the minimum lease payments is identical to the sale proceeds.

4. In order to generate improved sales on one of its older products, Colindale offered a promotion named 'something for free'. The promotion included free maintenance services for the first two years. On 1 October 2016, under the promotional offer, Colindale sold goods to a supermarket chain for €4.4 million. A two-year maintenance contract would normally be sold for €0.5 million, and the list price of the product would normally be €5 million. The transaction has been included in revenue at €4.4 million.

5. On the 10 October 2016, Colindale organised a Christmas party at the company's head office in Dublin. Unfortunately, there was an outbreak of food poisoning and the company has received 500 legal claims from employees in respect of the incident, seeking compensation at an average of €5,000 each. A letter from Colindale's legal advisors, dated 10 December 2016, suggest 40% of these claims are likely to be successful. Maria Bigoni does not want to make any provision for these claims on the grounds that less than 50% of the claims are likely to be successful. The legal advisors have suggested that an average of two years from the end of the current reporting period will elapse before the claims are settled. The risk related discount rate is estimated to be 10%.

6. Included in property plant and equipment is machinery which Colindale purchased for €18 million on 1 January 2014. The machinery has an expected useful life of ten years. On the 1 January 2016, the machinery was revalued to €20 million. On 4 January 2017, Paul Jones noted that an impairment review had been carried out and that the recoverable amount for the machinery was estimated at €11 million. A 'post-it' included in the impairment file indicated that the only accounting entries for the year ended 31 December 2016 in respect of this machinery were the revaluation and the depreciation charge based on the machine's revalued amount. You are aware that Colindale's accounting policy is to transfer any excess depreciation arising on revaluation of property, plant and equipment.

7. On 1 January 2014, Colindale purchased a €50 million social bond issued by a well-known housing association based in Cork. The bond pays a respectable 6% annual interest, which is also the effective rate of interest payable on 31 December. Colindale has classified the bond at fair value through profit and loss. At 31 December 2016, the carrying value of the bond is €50 million but there are reliable reports within the social sector that the housing association has financial difficulties. The market interest is now 8% and Paul Jones has estimated that the only amounts that will be received in disbursement of the bond are as follows:

Year	**Amount €m**
31 December 2016	4
31 December 2017	3.5
31 December 2018	42.5

Interest received for the accounting year ended 31 December 2016 has already been correctly accounted for.

8. On 1 November 2016, Sunningdale sold inventory to Colindale for €40 million. Sunningdale had marked up these goods by 25% on cost. At 31 December 2016, half of the inventory was still held by Colindale.

9. Colindale commenced construction of a new warehouse on 1 May 2016. The building was completed and available for use on 30 November 2016. The cost of construction amounted to €9 million, funded out of general borrowings, which comprise two bank loans as follows:

- €4 million of bank loan finance at 6% interest
- €6 million of bank loan finance at 4.5% interest

All interest costs have been expensed in the year to 31 December 2016. Ignore any depreciation in relation to the new warehouse.

REQUIREMENT:

(a) With reference to the issues raised by Maria Bigoni regarding the accounting treatment of leases, critically assess the possible implications arising from the introduction of IFRS16 - *Leases*.

(20 Marks)

(b) Prepare a memorandum for Maria Bigoni that includes the following:

(i) A critical evaluation of the possible financial reporting treatments of the sale and leaseback transaction and the purchase of the customer list identified in the case study for the year ended 31 December 2016.

(15 Marks)

(ii) An analysis of the required IFRS accounting treatment for the decontamination of the land, the machinery purchase, the social bond purchase and the legal claim arising from the food poisoning incident. 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 Colindale Group for the year ended 31 December 2016.

(20 Marks)

(iii) The consolidated statement of financial position of the Colindale Group as at 31 December 2016 in accordance with the relevant IFRSs.

(28 Marks)

Presentation (2 Marks)

(c) Appraise the ethical issues arising from the information provided in the case study, and propose and justify appropriate steps that Peter Kearns should take to address them.

(15 Marks)

[Total: 100 Marks]

APPENDIX 1:

Draft
Statements of Financial Position for Colindale, Sunningdale and Yardale as at 31 December 2016

	Colindale €m	Sunningdale €m	Yardale €m
ASSETS			
Non-current assets			
Property, plant and equipment	1,098	2,025	1,550
Intangibles	210	-	-
Investment in Sunningdale	2,050	-	-
Investment in Yardale	1,353	-	-
Financial assets	250		
	4,961	2,025	1,550
Current assets			
Inventories	300	160	110
Other current assets	2,188	1,793	765
Total Assets	7,449	3,978	2,425
EQUITY and LIABILITES			
Issued capital €1 ordinary shares	2,800	1,500	975
Retained earnings	2,674	1,078	763
Other Reserves	150	95	114
Total equity	5,624	2,673	1,852
Non-current liabilities	1,140	805	183
Current liabilities	685	500	390
Total liabilities	1,825	1,305	573
Total Equity and Liabilities	7,449	3,978	2,425

Appendix 2:

Discount Tables:

Year	6%	8%	10%
1	0.943	0.926	0.909
2	0.890	0.857	0.826
3	0.840	0.794	0.751
4	0.792	0.735	0.683
5	0.747	0.681	0.621

END OF PAPER

SUGGESTED SOLUTIONS

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These Are Suggested Outline Solutions Only. Candidates who present alternative and relevant approaches to the case study questions, will be awarded marks accordingly.

A broad range of answers would be acceptable here – it is important that candidates present their argument, make reference to recent pronouncements on leasing and refer to specific issues raised in the case study.

- The IASB has published IFRS 16 – the new leases standard. It comes into effect on 1 January 2019.

- Under existing rules (as set out in IAS17, Leases) lessees account for lease transactions either as operating or as finance leases, depending on complex rules and tests which, in practice, use 'bright-lines' resulting in all or nothing being recognised on balance sheet for sometimes economically similar lease transactions.

- 'Right-of-use' model replaces the 'risks and rewards' model. Lessees are required to recognise an asset and liability at the inception of a lease.

- All lease liabilities are to be measured with reference to an estimate of the lease term, which includes optional lease periods when an entity is reasonably certain to exercise an option to extend (or not to terminate) a lease.

- Under IFRS 16 lessees may elect not to recognise assets and liabilities for leases with a lease term of 12 months or less. In such cases a lessee recognises the lease payments in SPLOCI on a straight-line basis over the lease term. The exemption is required to be applied by class of underlying assets.

- The new requirements eliminate nearly all off balance sheet (SFP) accounting for lessees and redefine many commonly used financial metrics such as the gearing ratio and EBITDA. Most commonly used financial ratios and performance metrics will be impacted, such as gearing, current ratio, asset turnover, interest cover, EBIT, operating profit, net income, EPS, ROCE, ROE, and operating cash flows

- Statements of Financial Position will grow, gearing ratios will increase, and capital ratios will decrease. There will also be a change to both the expense character (rent expenses replaced with depreciation and interest expense) and recognition pattern (acceleration of lease expense relative to the recognition pattern for operating leases today).

- Practical implications for industry sectors e.g. Telecommunications.

- Refer back to the case study and comments made by Maria (Finance Director).

- Own views/comments.

(20 Marks)

(b) Memorandum: Confidential

To: Maria Bigoni

From: Peter Kearns

Subject: Colindale Group

Date: 25 April 2017

(i) Under IAS17 Leases, a lease is classified as a finance lease if it transfers substantially the risks and rewards incident to ownership. All other leases are classified as operating. In general a lease is a finance lease if:

- The lease transfers ownership of the asset to the lessee by end of the lease term
- The lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, that, at the inception of the lease, it is reasonably certain the option will be exercised
- The lease term is for the major part of the economic life of the asset, even if title is not transferred
- At the inception of the lease, the present value of minimum lease payments amounts to at least substantially all of the fair value of the leased asset
- The lease assets are of a specialised nature such that only the lessee can use them without modification being made.

In this case, Colindale are leasing back the building for the major part of the building's life and the present value of minimum lease payments amounts to all the fair value of the leased asset. Therefore, the lease should be treated as a finance lease. If the leaseback represents a finance lease, then in substance it is a financing transaction with the asset as security.

Accounting for the sale and lease back (see email and Note (3))
The sale of the building creates a gain of €2m. This is a deferred gain and should be released to profit and loss over the lease term. Therefore (€2m/20) €100000 will be recorded as income in the profit and loss account for 2016.

The asset and liability will be recorded at €8m

The asset will be depreciated over the shorter of the useful life and the lease term. Therefore, the depreciation expense in the profit and loss account for the year ending December 2016 will be (€8m/20) €400,000. The asset will have a carrying amount of €7.6m (€8 – €0.4) at the reporting date.

	Dr (m)	**Cr (m)**
PPM		6
Cash	8	
Non-current liabilities (NCL)		2
NCL	0.1	
Profit and Loss		0.1
NCL – lease obligation		8
PPM	8	
SPLOCI – depreciation	0.4	
PPM		0.4
SPOCI – finance charges	0.64	
NCL – lease obligation		0.64
Cash		0.71
NCL – lease obligation	0.71	

Interest will be charged on the lease liability at the rate of 8% per annum. This gives an interest expense of €640,000 (€8m x 0.08) in the SPLOCI and increases the lease obligation by the same amount. The cash payment of €710,000 will reduce the lease obligation, so the lease obligation at the reporting date will be € 7.93 (€8m +€0.64 – €0.71)..

(see email) Customer List

The customer list appears to satisfy the requirements of IAS 38 Intangible Assets – it is an identifiable, non-monetary asset without physical substance. The cost of the customer list can be identified as it was purchased from a third party. The customer list belonged to a competitor company and therefore, presumably it has future economic benefits.

The customer list should be capitalised at its cost of €21m and amortised over its estimated useful life. The work to extend the list represents an internally generated intangible asset and should therefore not be capitalised.

The useful life of the intangible should remain at three years because the additional two year life is part of an internally generated asset.

Therefore an amortisation charge of €21m/3 x 10/12 months = €5.8m should be recognised in the SPLOCI. The carrying amount should be €15.2m at the 31 December 2016.

	€m	€m
Dr Retained earnings	5.8	
Cr Intangible assets		5.8

The customer list should continue to be held at historical cost as a customer list is not assumed to have a fair value which can be measured with reference to an active market. The accounting policy choice therefore should be one of historical cost. Attempting to use a revaluation model would affect both the gearing and return on capital employed ratios.

(15 Marks)

(ii) *Decontamination of Land following environmental damage. (see narrative on page 3 of case study).*

The obligation to restore the land appears to have been in place since the contamination occurred. A provision should therefore be recognised at 31 December 2016. The provision should be increased each year by the discount rate (10%) and the increase recognised as a finance cost. An unwinding adjustment should be made in SPLOCI as a finance cost in respect of the year-ended 31 December 2016.

	€m	**€m**
Dr Finance costs (SPLOCI)	0.93	
Cr Provision		0.93

	€m
Provision at 1 January 2016	9.3
Unwind discount @ 10%	0.93
	10.23

Machinery purchase (see Note (6))

Carrying value of machinery at 31 December 2015 was (€18m - €18m/10 x 2) = €14.4, giving a revaluation gain on 1 January 2016 amounting to (€20m - €14.4) = €5.6

Machinery would have been depreciated by €20m/8 = €2.5m

Therefore the carrying value of the machinery is €20m - €2.5m = €17.5m

However, if the machinery had not been revalued, depreciation would have been €1.8m, so the reserve transfer is made for the excess depreciation amounting to 0.7m (€2.5m - €1.8m).

	€m	**€m**
Cr Retained earnings		0.7
Dr Other reserves	0.7	

Revaluation surplus left in other reserves is €6.6m - €0.7m = €5.9m
Impairment loss on machinery is therefore:

€17.5m - €11m = €6.5m

	€m	**€m**
Dr retained earnings (P&L)	1.6	
Dr Other reserves	4.9	
Cr PPE		6.5

Social bond (see Note (7))
As the bond is classified at fair value through the profit and loss, the fair value can be calculated by discounting expected future cash flows using the current market interest rate. Any change in fair value is taken to the profit and loss accounting for the current year.

Date	**flow €'000**	**8%**	**€'000**
31/12/16	4,000	1.0000	4,000
31/12/17	3,500	0.9259	3,240
31/12/18	42,500	0.8573	36,435
			43,675
Fall in FV charged to profit and loss			6,325
Carrying value of financial asset			50,000

	€m	€m
Cr Financial Assets		6.3
Dr Retained earnings	6.3	

Legal claim (see Note (5))
The food poisoning claims are covered by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. If there was a single claim, then it would be classified as a contingent liability, and no provision should be recognised in the SFP. This is because the outcome is possible not probable.

However, because there are 500 claims and each one has a 40% chance of succeeding, then overall Colindale would expect to lose 200 claims. Therefore, a provision should be recognised in the SFP because:

(i) There is an obligation at the end of the reporting period due to a past event
(ii) There is a probable outflow of economic resources
(iii) A reliable estimate can be made (200 claims at €5,000 each)

Because the claims are not expected to be settled for another two years, the provision should be discounted using the risk related time value of money. The provision should therefore be carried in the SFP at 31 December at:

500 X 5,000 X 0.40 X $1/(1.12)^2$ = €0.8m

	€m	**€m**
Dr SPLOCI (retained earnings)	0.8	
Cr Provisions (NCL)		0.8

(20 Marks)

(iii) *Note (4)*
Under IAS18 (IFRS 15), each component should be measured separately. As only three months of the maintenance service has been provided, we should only recognise 3/24 of the maintenance fee as revenue in the year ended 31 December 2016. The remainder should be treated as deferred income and recognised as the service is being provided.

The sale of goods, however, should be recognised immediately.

As the total of the fair values exceeds the overall price of the contract, a discount has been provided. As we do not know what has been discounted, it would seem reasonable to apply the same discount percentage to each separate component. The discount is 20% based on listed prices (i.e. [4.4m/5m + 0.5] – 1).

	€m
Sale of goods (€5m x 80%)	4
Sale of services (3/24 x €0.5m x 80%)	0.05
Revenue to be recognised in year ended 31 December 2016	4.05

Deferred income should be measured at €0.35m (21/24 x €0.5m x 80%). Revenue (retained earnings should therefore be reduced by €0.35m.

	€m	**€m**
Dr Retained earnings	0.35	
Cr Deferred Income (CL)		0.35

(8) Unrealised profit on intra-group trading with Sunningdale

Intragroup sales are €8m on which Colindale made a profit of €8m (€40m x 25/125)

	€m	€m
Dr Post acq profits of Sunningdale	4	
Cr Inventory Colindale		4

(9)
IAS 23 *Borrowing costs* provides that borrowing costs that are directly attributable to the acquisition or construction of a 'qualifying asset' form part of the cost of that asset. The amount of borrowing costs that should be capitalised is calculated by reference to the weighted average borrowing costs of general borrowing.

Interest rate to use is:

$$\frac{(€4m \times 6\%) + (€6m \times 4.5\%)}{€10m} = 5.1\% \text{ (say 5\%)}$$

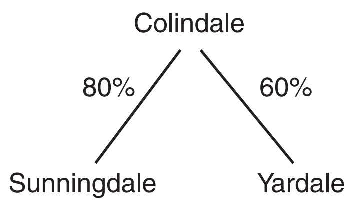
Borrowing costs to be capitalised are: €9m x 5% x 7/12 = €0.26m (approximately €0.3m)

	€m	€m
Dr NCA (PPE)	0.3m	
Cr SPLOCI (retained earnings) Colindale		0.3m

Colindale Group
Consolidated Statement of Financial Position as at December 2016

	€m
Non-current assets	
Property, plant and equipment: (1,098 + 2,025 + 25 +1,550 + 20{– 6 +8 -0.4} -5.5 + 0.3 - 180	4,534.4
Goodwill (W2 & W3))	443.6
Other Intangible Assets (210 - 5.8)	204.2
Financial assets (250 - 6.3)	243.7
	5,425.9
Current assets	
Inventories (300 + 160 + 110 - 4)	566
Other Current Assets (2,188 + 1,793 + 765 {+ 8 – 0.71}	4,753.3
Total assets	**10,745**
Equity and liabilities	
Share capital	2,800
Retained profits (W6)	2,843.3
Other reserves (W7)	215.8
Non-controlling interests (W5)	1,171.2
Non-current liabilities (1,140 + 805 + 183 + {2 + 8 + 0.64 - 0.71} + 0.93 + 0.8 – 0.1	2,139.6
Current liabilities (685+ 500 + 390 + 0.35)	1,575.35
Total Equity and liabilities	**10,745**

W1
Workings – group structure



Presentation Marks (memo CBS etc)

W2 Net assets
Sunningdale

	At Acquisition date	At Reporting date
	€m	€m
Share capital	1,500	1,500
Retained earnings	225	1,078
Other reserves	50	95
FVA – Land balancing figure	25	25
	1,800	2,698

Yardale

	At Acquisition date	At Reporting date
	€m	€m
Share capital	975	975
Retained earnings	541	763
Other reserves	55	114
FVA – Land balancing figure	20	20
	1,591	1872

W3
Goodwill- Sunningdale

	€m
Consideration transferred for 80%	2,050
NCI at date of acquisition (1,800 x 20%)	360
Less FV of identifiable assets acquired and liabilities assumed W2	(1,800)
Goodwill	610
Less Impairment	(208.4)
	401.6

W3
Goodwill Yardale

	€m
Consideration transferred for 60%	1,353
Fair value of NCI	680
Less FV of identifiable assets acquired and liabilities assumed W2	(1,591)
Goodwill	442
Less Impairment	(400)
	42

Total goodwill at the reporting date is therefore €401.6 + €42 = €443.6m

Net assets transferred as part of the consideration need to be removed from the NCA, and the gain on disposal needs to be calculated. The sale consideration of €205m has been recorded in profit. The carrying amount of the asset is €180m, giving a gain on disposal of €25m. The adjustment required is therefore:

	€m	€m
Dr Retained earnings	180	
PPE		180

W4
Goodwill impairment
Yardale

	€m
Goodwill W3	442
Identifiable net assets at reporting date W2	1,872
	2,314
Recoverable amount (per question)	(1,914)
Goodwill impairment	400

The good will impairment relating to Yardale will be split 60/40 between the group and the NCI.

	€m	€m
Dr Retained earnings	240	
Dr NCI	160	
Goodwill		400

Sunningdale

	€m
Goodwill W3	610
Notional NCI (610 x 20/80)	152.50
Total notional goodwill	762.50
Identifiable net assets W2	2,698
	3,460.5
Recoverable amount	(3,200)
Impairment	260.5

The impairment is allocated to the notional goodwill, however only 80% of the notional goodwill has been recognised in the consolidated financial statements. Therefore goodwill impairment recognised is €208.4m (260.5 x 80%). As this expense is all attributable to the group and therefore retained earnings are debited with €208.4m.

	€m	€m
Dr Retained earnings	208.4	
Goodwill		208.4

W5 NCI

	€m
Sunningdale:	
NCI at acquisition W3	360
NCI (share of post-acq assets)	
20% x (2,698 – 1,800)	179.6
NCI share of URP in inventory (iv)	(0.8)
Yardale:	
NCI at acquisition W3	680
NCI (share of post-acq assets)	
40% x (1,872 – 1,591)	112.4
Impairment of goodwill Yardale W4	(160)
	1,171.2

W6
Retained earnings

	Colindale €m	Sunningdale €m	Yardale €m
Per case study	2,674	1,078	763
Deferred gain (re sale/lease back) (b)i	0.1		
Depreciation (re lease/lease back) (b)i	(0.4)		
Finance charges (re sale/lease back) (b)i	(0.64)		
Amortisation of customer list (intangible) (b)i	(5.8)		
Decontamination of land (b)ii	(0.93)		
Special sales promotion (b)iii - note 4	(0.35)		
Legal claim - note 5	(0.8)		
Transfer excess depreciation - note 6	0.7		
Impairment loss on machinery - note 6	(0.6)		
Loss on social bond - note 7	(6.3)		
Unrealised profit- trade with Sunningdale - note 8		(4)	
Interest capitalised - note 9	0.3		
Sale consideration of assets (for Yardale acq)W3	(180)		
Impairment goodwill Sunningdale	(208.4)		
Impairment goodwill Yardale	(240)		
Pre-acquisition (per case study)		(225)	(541)
	2031.88	849	222

Group share		
Sunningdale: x 80%	679.2	
Yardale: x 60%	133.2	
	2,829.9	

W7
Other reserves

	€m
Colindale	150
Sunningdale (80% x (95-50)	36
Yardale 60% x (114 – 55)	35.4
Transfer excess depreciation (7)	(0.7)
Revaluation adjustment (7)	(4.9)
	215.8

Including presentation marks (30 Marks)

(c) Ethical issues

- Classification of a lease can be quite subjective. In the case of land, this is particularly subjective as the title may not pass to the lessee at the end of the lease agreement. If the features of the lease meet conditions set down in IAS 17 Leases yet the directors want to understate liabilities in order to raise a loan, then an ethical dilemma arises.
- Maria's year-end bonus, contingent on treatment of the lease, represents a conflict of interest.
- As a CPA, you should consider the Code of Ethics in formulating a way to resolve the conflict that appears to be developing. It is essential that CPAs do not succumb to pressure from management so that financial information is prepared in a misleading manner.
- If matter cannot be resolved with Maria, then further discussions need to be held with your immediate line manager and/or others within the business such as non-executive directors. Perhaps take confidential advice from CPA.
- If Maria tells Randall about the liquidity issues surrounding Paradox, is she betraying trust? However, if she does not mention the liquidity problem, then amounts owing to Randall may not be paid. Can the information be deemed to come under insider information' and therefore it should not be disclosed. If Paradox goes into liquidation, then then Maria's reputation and career may suffer.
- This issues facing Maria are not simply a matter of following rules but are a complex mix of issues concerning trust, duty of care, accountability and confidentiality.
- You need to ascertain the facts regarding the marketing director's shareholding in Survey. Presumably, the shareholding has been disclosed to the board and any related party issues discussed/disclosed. What is the motivation to provide a higher valuation? Your friend, and other work colleagues in Colindale, may have been disgruntled and looking to make trouble for the marketing director. If in doubt you should contact CPA for advice as to how to proceed.

(15 Marks)

[Total: 100 Marks]