CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

ADVANCED CORPORATE REPORTING

PROFESSIONAL 2 EXAMINATION

APRIL 2014

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
Beta Block Pharmaceuticals plc (Beta Block) is an Irish listed company which prepares financial statements in accordance with International Financial Reporting Standards (IFRS) up to 31 December each year. Beta Block has recently acquired shares in Statin Limited (Statin) and Maxlon Limited (Maxlon), and prepares consolidated financial statements in accordance with IFRS. Draft Statements of Financial Position for each company are provided in **Appendix 1**. The company was founded twenty five years ago by John Carter and Sarah Benton, chairman and managing director, respectively, to develop and sell drug therapies for the condition of dementia. During the early years of operation, the company developed, licensed and sold a drug, 'Alpha', which has been extremely successful at delaying the onset of early stage dementia.

You are a Certified Public Accountant (CPA) and have recently been appointed as financial controller of Beta Block. You have no previous experience within the pharmaceutical industry, but remember doing case study questions, many of which were based on the pharmaceutical industry, as part of your studies to become a qualified CPA. You report to Helen Singh, the finance director of Beta Block. Yesterday, you received the following email from Helen.

Hi,

As you are aware, I have to present some financial information at the board meeting scheduled for next week and I need your help. Your predecessor prepared some briefing notes (see below) regarding the preparation of the consolidated financial statements of the Beta Block Group for the year ended 31 December 2013. Please note that it is the group's policy to value its non-controlling interests at fair value. The fair value of the non-controlling interest in Statin at the 1 January 2013 was €79.5 million.

On a separate issue, you are probably aware that we have been trying to finalise the reporting of the sale and leaseback transaction in the financial statements of Beta Block for the year end. I can't remember if I told you, but your predecessor had problems concluding whether this transaction was a sale and finance leaseback or a sale and operating leaseback transaction. I have provided some details on this (see briefing note on Page 2). I am very concerned about this transaction and have not discussed it with the auditors. I would like to understand how the different treatments of the lease transaction would affect the financial statements. I want to maximise profit and minimise debt at all costs. Maybe if one approach is better that the other, then we could create the necessary documentation and reasoning to achieve what we want. For example, with my profile in the industry, we should be able to justify any remaining useful life to anyone. Also, we are seriously thinking of making a bid for Henson Limited, a small biotechnology firm based in Letterkenny, Co. Donegal. I remember at your interview you mentioned that you had a friend who worked there. Maybe you could try and find out whether they have prepared their latest management accounts and, if they have, what markets they are seeking to exploit in the next two years.

By the way, I was on a leadership course for financial directors last month and one of the speakers was arguing that more narrative information in the form of a 'management commentary' should be included in the annual financial statements. Personally speaking, I think this is just another one of those accounting innovations where subjectivity is involved. We are under pressure to discharge accountability to a wide range of stakeholders, but surely the goal of maximising profit will always determine which accounting practice we should follow. Our so called 'Conceptual Framework' reinforces the view that suppliers of capital are the important user group. Anyway, whatever the limitations of traditional financial reporting, providing more information is, in my view, just too costly for preparers.

One final point, you may be aware that on 18 January 2014 we are intending to have a formal announcement in relation to the restructuring plan (Appendix 1 – Note 1) which I have been working on and which has now been approved. I am not sure whether this will have implications for the consolidated financial statements, but please just ignore these in preparing the Group financial statements for the year ended 31 December 2013. We can discuss any changes arsing from the restructuring plan at a later date.

On a completely separate matter – we must arrange a celebration for your birthday, which we will do after we get the year-end financial statements finalised.

Best regards.
Helen

After reflecting on the email from Helen, you begin to consider why your predecessor left the company. From the little information you have been able to gather, you understand that he was employed for a five-month period, and most certainly did not get on well with Helen. From your short time working with Helen, you consider her to be focused, hardworking and very demanding on all the staff working in her team.

One aspect of working in the pharmaceutical industry that has caught your attention is the significant amount of expenditure on the development of new products. It is your understanding that these costs were formerly written off to profit and loss and other comprehensive income as incurred but then reinstated when the related products, mainly drugs, were brought into commercial use. These reinstated costs are included within inventories as 'development inventories'. The costs do not meet the criteria in IAS 38 *Intangible Assets* for classification as intangibles and it is most unlikely that the net cash inflows from these products will be in excess of the development costs. In the current year, Statin has included €15m of which €5m relates to expenditure on a product written off in periods prior to 1 January 2011. Commercial sales of this product had commenced during the year ended 31 December 2013. Your predecessor did not seem too concerned whether the financial statements complied strictly with IFRS in relation to this matter.

On speaking to Ella Johnson, the assistant accountant, you ascertain that Beta Block purchased 4% debentures in Y Limited on 1 January 2012 (their issue date) for €1m. The term of the debenture issue was four years and the redemption value is €1.3m. The effective rate of interest on the debentures is 10% and the relevant IAS/IFRS conditions are satisfied for the investment to be held at amortised cost. However, at the end of November 2013, Y Limited was declared bankrupt. All interest had been paid until that date. On 31 December 2013, the liquidator announced that no further interest would be paid and only 80% of the maturity value would be repaid, on the original repayment date. The figure, rounded to the nearest million, included for this financial instrument in the draft statement of financial position (Appendix 1) amounted to €1,126,000. Having discussed the accounting treatment with Ella, you are still unsure as to how the latter figure was arrived at and whether it needed to be adjusted. Ella also informs you that, because internal audit makes such a significant contribution to Beta Block's overall profitability, the directors of Beta Block are proposing to award the head of internal audit a bonus based on current annual profits.

You go back to your office and begin to scan the briefing notes (see below) left by your predecessor. The first thing you notice is that there is no further information provided in relation to the debenture purchase. For a moment, you feel incredibly stressed, and wonder whether you had made the right decision in joining Beta Block. You quickly learnt that Helen expects high standards and failure to meet deadlines is just not an option. You recollect the times when you were studying for the professional examinations, and how many of the issues in the case studies required candidates to exercise their professional judgement in an ethical manner. You pour yourself a large coffee, quickly refocus your mind and begin to work on the briefing issues (see below); it is going to be a long week.

Briefing notes:

1. At the front of the file containing the Briefing Note the folowing information was provided in relation to the Sale and Leasback transaction:

    (i) The machinery has a carrying amount of €10 million on 1 January 2013.
    (ii) The remaining useful life of the machinery on that date has been estimated as eight years by Helen Singh.
    (iii) Proceeds from the lease company of €12 million were received on 1 January 2013. It is your understanding that this represents the market value of the machinery at that date.
    (iv) Beta Block has leased the machinery back over a six-year period. The first of six equal annual payments of €2.5 million is to be paid on 31 December 2013.
    (v) Beta Block has the option to purchase the machinery for it's market value at the end of the six-year lease term. It is still not clear whether this will in fact happen.
    (vi) The rate of interest implicit in the lease (if it were to be classified as a finance lease) has been calculated as 6.5% per annum.

2. The following information is relevant regarding the acquisition of shares in Statin and Maxlon:

Date of acquisition	*Holding acquired*	*Retained earnings at acquisition*	*Purchase consideration*
	%	*€m*	*€m*
Statin: 1 January 2013	80	225	400
Maxlon: 1 January 2013	30	390	360

Statin and Maxlon have not issued any share capital since the acquisition of shareholdings by Beta Block. The fair value of the net assets of Statin and Maxlon were the same as their carrying amounts at the date of acquisitions. Beta Block has significant influence over Maxlon. An impairment loss of €8m has been identified in respect of goodwill arising on the acquisition of Statin for the year ended 31 December 2013. The recoverable amount of net assets of Maxlon has been deemed to be €980 million at 31 December 2013.

3. Beta Block sold some trade receivables, which arose during December 2013, to a factoring company on 31 December 2013. The trade receivables sold are unlikely to default in payment based on past experience but they are long dated with payment not due until 1 July 2014. Beta Block has given the factor a guarantee that it will reimburse any amounts not received from the factor. Beta Block received €90 million from the factor, being 90% of the trade receivables sold. The trade receivables are not included in the statement of financial position of Beta Block and the balance of €9 million (10% of trade receivables factored) which has not been received from the factor has been written off against retained earnings.

4. As an incentive to persuade a new customer to buy a large quantity of a new drug, Gamma, Beta Block offered a deferred payment arrangement. The drug, with a selling price of €5 million, was delivered to the customer on 1 January 2013. The customer paid 20% of the selling price on that date. The balance will become payable on 1 January 2015. The applicable finance charge is 6% per annum. €5 million was recognised as revenue in the draft financial statements in respect of this transaction.

5. Beta Block has contracted to purchase a specialised item of machinery from a company based in America for $20 million on the following terms:

Payable on signing of contract (1 October 2013)	60%
Payable on delivery and installation (5 January 2014)	40%

The amount payable on signing the contract (the deposit) was paid on the due date and is refundable. The following exchange rates are relevant:

	Euros to dollar
1 October 2013	0.80
31 December 2013	0.75
5 January 2014	0.79

The deposit is included in trade receivables at the exchange rate on 1 October 2013. For this type of machinery, a full year's charge for depreciation is made in the year of acquisition using the straight line method over five years.

6. On 1 November 2013, Beta Block sold inventory costing €25 million to Maxlon for €35 million. At 31 December 2013, the inventory was still held by Maxlon. On 10 January 2014, the inventory was sold to a third party for €42 million.

7. Included under current liabilities in Beta Block's statement of financial position is a provision of €28 million in respect of a legal claim made by a customer against the company in November 2012. The claim is still outstanding at 31 December 2013 and is expected to be settled within the next eight weeks. Lawyers for Beta Block believe that the customer has a strong case and, following recent discussions with all parties involved, the probabilities of the levels of damages payable are estimated as follows:

Damages payable	*Probability*
0	15%
€32m	45%
€40m	25%
€70m	15%

8. Beta Block acquired a new factory on 1 January 2013. The cost of the factory was €60 million and it has a residual value of €4 million. The factory has a flat roof which needs replacement every five years. The cost of the roof was €5 million. The useful economic life of the factory is 30 years. No depreciation has been charged for the year in relation to this asset. Helen has instructed you to account for the factory and roof as a single asset and depreciate the whole factory on a straight line basis.

9. On 1 April 2013, Beta Block commenced construction of a new distribution centre. The building was completed and available for use on 30 November 2013. The cost of construction amounted to €4.5 million, funded out of general borrowings, which comprise two bank loans as follows:

(i) €2 million of bank loan finance at 6% interest

(ii) €3 million of bank loan finance at 4.5% interest

Ignore any depreciation in relation to the new distribution centre.

Other Information:

Extracts from the Present Value tables (discount rates) at 6% and 10% follow.

Year	**Discount rate**	
	6%	**10%**
1	0.943	0.909
2	0.890	0.826
3	0.840	0.751
4	0.792	0.683
5	0.747	0.621

REQUIREMENT:

(a) Prepare a memorandum for Helen Singh that includes:

(i) A critical analysis of the two possible financial reporting treatments of the sale and leaseback transaction identified in the case study for the year ended 31 December 2013.

(15 Marks)

(ii) An appraisal of the required IFRS accounting treatment for the development inventories, deferred payment for the new drug (Gamma), debenture purchase, factoring of trade receivables, and the legal claim. As part of the process, 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 Beta Group for the year ended 31 December 2013.

(20 Marks)

(iii) The consolidated statement of financial position of the Beta Group as at 31 December 2013, in accordance with the relevant IFRS's. (Note: For the purposes of answering this part of the question you may assume that the sale and leaseback transaction in **(a)** (i) is a sale and operating leaseback).

(29 Marks)

(iv) A justification outlining the appropriate accounting treatment in relation to the costs associated with restructuring the group (Appendix 1 – Note 1).

(6 Marks)

Format & Presentation (2 Marks)

(b) Summarise the ethical issues arising from the information provided in the case study, and recommend appropriate steps which should be taken to address them.

(11 Marks)

(c) Argue critically whether the preparation of financial statements within the context of a set of global accounting standards, imposes limitations on the extent to which those financial statements can discharge accountability to the users of such statements.

(17 Marks)

[Total: 100 Marks]

Appendix 1:

Draft Statements of Financial Position for Beta Block, Statin and Maxlon as at 31 December 2013

	Beta Block	Statin	Maxlon
	€m	€m	€m
ASSETS			
Non-current assets			
Property, plant and equipment	3,400	300	450
Intangible assets	600	-	-
Investment in Statin (at cost)	400	-	-
Investment in Maxlon	360	-	-
Financial assets	1		
	4,761	300	450
Current assets			
Inventories	1,600	150	225
Trade receivables	1,200	90	120
Cash	1,000	60	30
	3,800	300	375
Total Assets	**8,561**	**600**	**825**
EQUITY and LIABILITES			
Issued capital 1€ ordinary shares	3,000	150	300
Other reserves	600	-	-
Retained earnings	801	300	450
Total equity	4,401	450	750
Non-current liabilities	1,400	-	-
Current liabilities	2,760	150	75
	4,160	150	75
Total Equity and Liabilities	**8,561**	**600**	**825**

Note 1:

On 18 January 2014, a formal announcement for a restructuring of the Beta Group was made. No provision has been made in the financial statements as a public issue of shares is being planned and the directors do not wish to lower the reported profits. Prior to the year end, the company has sold certain plant and issued redundancy notices to some employees in anticipation of the formal commencement of the restructuring. Helen Singh has prepared a formal plan for the restructuring which has been approved by the board of directors and communicated to the trade union representatives. It is estimated that the cost of restructuring includes €12 million for re-training and relocating existing employees, and the directors feel that costs of €18 million (of which €5 million is relocation expenses) will have been incurred by the time the financial statements are approved.

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

ADVANCED CORPORATE REPORTNG

PROFESSIONAL 2 EXAMINATION - APRIL 2014

SOLUTION

(a) MEMORANDUM
To: Helen Singh, Finance Director.
From: Ho Hum, Financial Controller.
Date: 29 April 2014
RE: Financial Statements for the year ended 31 December 2014 – Various issues

This memo is written in response to your latest e mail to me concerning the year-end financial statements, my review of the briefing notes and some additional research I have undertaken.

Included below is:

(i) A critical analysis of the two possible reporting treatments of the sale and leaseback transaction in the financial statements of Beta Block
(ii) An appraisal of the accounting treatment required under IFRS for the development inventories, deferred payment for Gamma (the new drug), debenture purchase, factoring of trade receivables, and the legal claim
(iii) A consolidated statement of financial position of the Beta Group as at 31 December 2013, and
(iv) An outline, with justifications, of the accounting treatment of each of the costs associated with the restructuring of the group.

(i) Sale and leaseback

The sale and leaseback of the machinery can result in either an operating or finance lease. The classification is determined by using the principle of substance over form. This decision will drive the financial reporting treatment.

Sale and operating leaseback

When a transaction is classified as a sale and operating leaseback, then the risks and rewards associated with ownership will have been transferred to lessor (who acquired the machinery) and have been disposed of by Beta Block.

The substance of the transaction is that a sale has taken place both in legal terms and in substance as the risks and rewards are not subsequently reacquired when the leaseback is an operating leaseback. As a genuine sale has occurred, then the profit or loss on disposal of the original asset should be recognised. The profit on the transaction amounting to €2m (12 -10) should be recognised immediately in the statement of profit or loss and OCI (SPLOCI) on 1 January 2013. The rental payments for the period should be recognised in profit or loss on an accruals basis. The SPLOCI for the year should include the first payment.

Sale and finance leaseback

If the leaseback represents a finance lease, then in substance it is a financing transaction with the asset as security. The risks and rewards of ownership have not been transferred to the lessor and it is not appropriate to consider the €2m surplus of the proceeds over the carrying amount as a profit to be recognised in the year to 31 December 2013. It should be deferred and amortised over the lease term.

The transaction should be dealt with in the SFP by removing the €10m 'owned' machinery and recognising both a leased asset of €12m and a lease liability of the same amount. Interest in the year ended 31 December 2013 should be calculated as €780,000 (6.5% x €12m). The remainder of the repayment €2.5m should be treated as repayment of capital.

Year ended	**Bfwd**	**Interest (6.5%)**	**Paid**	**Closing**
	€'000	**€'000**	**€'000**	**€'000**
2013	12,000	780	(2,500)	10,280
2014	10,280	668.2	(2,500)	8,448.2

The lease liability should be split between current liabilities of €1,791,800 (10,280 – 8448.2) and non-current liabilities of €8,448,200. As there is no certainty whether the machinery will be reacquired at the end of the lease term, the asset should be depreciated over the shorter of useful life and lease term. Depreciation of €2m (12,000/6) should be recognised in the SPLOCI and the carrying amount of the asset at the year-end should be €10m.

Deferred income of €0.33m should be released to profit or loss.

	Sale and operating leaseback €'000	Sale and finance leaseback €'000
SPLOCI		
Cost of sales		
Gain on disposal of machinery	2,000	
Lease rentals	(2,500)	
Depreciation		(2,000)
Deferred income		333.33
Finance expenses		
Interest		(780)
SFP		
Non-current assets		
Machinery held under finance lease (€12m-€2m)		10,000
Non-current liabilities		
Finance lease obligations		(8,448.2)
Deferred income		(1,340)
Current liabilities		
Finance lease obligations		(1,792)
Deferred income		(330)

Note: good candidates may also refer to the current proposals to revise IAS 17 *Leasing* and to abolish the distinction between operating and financing leases. Also depending on how sale leaseback is classified, there will be implications for the ratio calculations (e.g. gearing and ROCE in particular).

(ii) Accounting treatment of various issues as required using IFRS

Development inventories

The development costs do not meet the recognition criteria set out in IAS 28 *Intangible assets* and, therefore, they cannot be treated as inventory because they were previously written off as incurred. They were reinstated after acquisition, so must be written off Statin's post-acquisition reserves.

	€	€
Dr Retained earnings (Statin)	5	
Cr Inventories (Consolidated SFP)		15

Deferred payment – Gamma

This is an issue surrounding revenue recognition (IAS 18 *Revenue*). Where an extended period of credit is offered to a customer, revenue recognised as two elements: first the fair value of the goods on date of sale, and second, financing income. Future receipts from the customer should be discounted to present value at an imputed interest rate, in this case 6%.

The customer paid €1m on 1 January 2013 (€5m x 20%). At that date the present value of the amount receivable on 1 January 2015 was (€5m x 80%) x 1 /(1.06)2 = €3,560,000 (nearest '000).

Revenue to be recognised in this transaction in the financial statements to the year ended 31 December 2013:

	€'000
Sale of goods (€1,000,000 + €3,560,000)	4,560
Financing income (€3,560,000 x 6%)	214
	4,774
Carrying amount of receivable (€3,560,000 x 1.06)	3,774

Beta Block has recognised €5 million in revenue regarding this transaction and therefore adjustment of €226,000 (€0.2m approx) is required.

	€	**€**
Dr SPLOCI (retained earnings)	226,000	
Cr Trade Receivables (SFP)		226,000

Debentures
The debentures are classified as held at amortised cost:

	€'000
Initial cost	1000,000
Interest @ 10%	100,000
Cash @ 4%	(40,000)
At 31 December 2012	1,060,000
Interest @10%	106,000
Cash @ 4%	(40,000)
At 31 December 2013	1,126,000

After the impairment, the debentures are stated at their recoverable amount (using the original effective interest rate of 10%):

80% x €1,1 x 0.826 = €726,880
An impairment loss of €399,120 (€1,126,000 - €726,880) should be recorded as follows:

	€m	**€m**
Dr SPLOCI (retained earnings)	0.4	
Cr Financial asset		0.4

Debt factoring
Under IFRS 9 *Financial instruments* a financial asset must be derecognised if:

(i) The contractual rights to the cash flows have expired
(ii) The financial asset has been transferred, together with the risks and rewards.

Condition (ii) has clearly not been met. Beta Block still bears the risks and rewards of ownership. Accordingly, the receivable must be reinstated.

	€m	**€m**
Dr Receivables (SFP)	90	
Cr Retained earnings		9
Cr Loan (current liabilities)		81

Provision – IAS 37
From the figures provided it would be more prudent to make a provision for €32m. There is every likelihood that the customer will win the case and it is probable that €32m will be the amount awarded. Provision in SFP should be increased by €4m and profit/retained earnings will be reduced by the same amount.

	€m	**€m**
Dr SPLOCI (retained earnings)	4	
Cr Provisions		4

(iii) Beta Group
Consolidated Statement of Financial Position as at December 2013

	€m
Non-current assets	
Property, plant and equipment: (3,400 + 300 - 10 – 2.7 (W6) + 0.2(W9)	3,687.5
Goodwill (W2)	96.5
Other intangible assets	600
Investment in associate (W3)	294
Financial assets (1 - 0.3 – see a(ii))	0.6
	4,678.6
Current assets	
Inventories (1,600 + 150 - 15)	1,745
Trade receivables (1,200 + 90 - 0.6 (W7) - 0.23 + 90) {see a (ii)}	1,379.3
Cash (1,000 + 60 - 2.5 + 12) {see a (ii)}	1,069.5
Total assets	8,872.4
Equity and liabilities	
Share capital	3,000
Retained profits (W4)	785.4
Other reserves	600
Non-controlling interests (W8)	92
Non-current liabilities	1,400
Current liabilities (2,760 + 150 + 81+ 4) {see a (ii)}	2,995
Total Equity and liabilities	8,872.4

My workings for the Consoilidated Statements of Finacial Position follow:

W1
Workings – group structure

Beta Block

80% 30%

Statin Maxlon

	Statin	Maxlon
Pre-acquisition retained earnings	€225	€390

W2
Goodwill- Statin

	€m	€m
Consideration transferred		400
Non-controlling interests		79.5
FV of identifiable assets acquired and liabilities assumed		
Share capital	150	
Retained earnings	225	(375)
		24.5
Less Impairment		(8)
Goodwill		96.5

W3
Investment in associate

	€m
Cost	360
Share of post acquisition profits	18
Unrealised profit on inventories	(3)
Impairment loss (SPLOCI/retained earnings) (balancing)	(81)
Recoverable amount – 30% x €980m (per question)	294

W4
Retained earnings

	Beta Block	Statin	Maxlon
	€m	€m	€m
Per case study	801	300	450
Foreign currency (W7)	(0.6)		
Debt factoring reversal	9		
Provision	(4)		
Unrealised profit- trade with Maxlon	(3)		
Financial asset	(0.4)		
Revenue adjustment	(0.2)		
Depreciation on factory/roof (W6)	(2.7)		
Borrowing costs	0.2		
Operating lease	(2.5)		
Profit on sale of leased machinery	2		
Development inventories		(5)	
Pre-acquisition		(225)	(390)
		70	60
Group share			
Statin: 70 x 80%	56		
Maxlon: 60 x 30%	18		
Less group impairment losses:			
Statin: 80% x 8	(6.4)		
Maxlon W3	(81)		
	785.4		

W5
Unrealised profit on intra-group trading with associate (Maxlon)

	€m
Inventories selling price	35
Cost	25
Profit	10

IAS28 requires that Beta Block's share of this profit must be eliminated. Beta Block's share is 30% x €10m = €3m

	€m	€m
Dr SPLOCI (retained earnings) Beta Block	3	
Cr Investment in associate		3

The unrealised profit is eliminated from retained earnings in books of seller (Beta Block) and from inventories in the books of the holder (Maxlon) – i.e. investment in associate.

W6
Depreciation of factory

		Building	Roof	Total
		€m	€m	€m
Cost		55	5	60
Depreciation:				
(55-4)/30years	5/5years	(1.7)	(1)	(2.7)
		53.3	4	57.3

	€m	€m
Dr SPLOCI (retained earnings) Beta Block	2.7	
Cr PPE		2.7

W7
Foreign currency contract

The payment to the supplier is a refundable deposit. It is deemed to be a monetary amount and is translated at the year-end.

At 1 October 2013
$20m x 60% x 0.80 = €9.6m

At year-end (31 December 2013)
$20m x 60% x 0.75 = €9m

Loss of €0.6m

	€m	€m
Dr SPLOCI (retained earnings) Beta Block	0.6m	
Cr Receivables		0.6m

W8
Non- controlling interest: Statin

	€m
NCI at acquisition	79.5
NCI share of post acquisition profits (70 x 20%)	14
Less NCI share of impairment loss (8 x 20%)	(1.6)
	91.9

W9
IAS 23 *Borrowing costs* provides that borrowing costs that are directly attributable to the acquisition or construction of a 'qualifying asset' form part o 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:

$$\frac{(€2m \times 6\%) + (€3m \times 4.5\%)}{€5m} = 5.1\% \text{ (say 5\%)}$$

Borrowing costs to be capitalised are: €4.5m x 5% x 8/12 = €0.15m (approximately €0.2m)

	€m	€m
Cr SPLOCI (retained earnings) Beta Block	0.2m	
Dr Non-current assets (PPE)		0.2m

(iv) Key issues re costs of restructuring

- Helen should be aware that IAS 37 *Provisions, contingent liabilities and contingent assets* contains specific requirements relating to restructuring provisions. A provision should be made if an entity has a constructive obligation to carry out a restructuring. Such an obligation exists if management has a detailed formal plan for the restructuring and has also raised a valid expectation in those affected by the change.
- Beta Block made an announcement of the restructuring after the year end, but the plan had been drawn up before 31 December 2013 and there was evidence it was being implemented (communication with trade unions etc). A constructive obligation exists and therefore a provision should be made.
- IAS 37 states that only direct expenditure arising from the restructuring should be accounted for. Future costs (training/relocation costs) should not be provided for.
- Measurement of a provision will be difficult but a best estimate has to be made.
- As a minimum €13m (€18m - €5m) should be provided for. There is also an argument for providing a higher figure, given the information provided in the case study (Appendix 1).

I will pleased to provide any further information or explanation that you may require regarding any of the above.

Ho Hum CPA.

(b) Ethical issues

- There are threats to your integrity and objectivity arising from Helen Singh's wanting to create a preferred financial reporting treatment by omitting or obscuring information or creating materially false documentation.
- 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.
- Further information about the lease transaction needs to be obtained. For example, can the lessor be contacted?
- If matter cannot be resolved with Helen, 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.
- Also, in addition to the lease transaction issue, you have been requested to get some 'inside information' on a potential competitor – Henson Limited. Again, this would be considered inappropriate behaviour from a qualified CPA.
- The introduction of a 'bonus' for head of internal audit would be of serious concern, particularly in relation to the independence of the internal audit function. There would be an incentive to engage in 'creative accounting' so that current consolidated profits are as high as possible. Again, the matter needs to be addressed with Helen Singh.

(c) *A range of answers would be acceptable here – it is important that candidates present both sides of the argument and refer to specific issues raised in the case study.*

- Importance of having a 'Conceptual Framework' – forms the theoretical basis for determining which events should be accounted for, how they should be measured and how they should be communicated to the user.
- Such a framework can bolster standard setters against political pressure from 'lobby groups' and interested parties.
- Discussion of key users of financial statements (owners, managers, customers, investors etc)
- Limitations of financial reporting – fails to account for externalities (e.g. BP Deep Water oil spill). Backward looking, therefore information is of limited use. Decision usefulness to who? – Suppliers of capital (effectively shareholders) – limited accountability.
- What happened 'stewardship function' of accounting.
- Estimates and many areas of judgement – do accountants construct their reality of how the world is?
- IFRS 8 Operating segments requires entities to disclose information which enables users to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. However, management may report segments which are not consistent for internal reporting and control purposes.
- Conceptual Framework supports the view that information on financial performance and position should be primarily for suppliers of capital.
- Narrow view of accountability/serves capitalist system – what about other key stakeholders?
- Contract an organisation should have with society (e.g. Banks). Ethic of accountability.
- Need wider system of reporting (e.g. Environmental/sustainability/integrated reporting).
- Cost of preparing reports (e.g. separate sustainability report) for different users can be prohibitive.
- Advantages/disadvantages of a 'management commentary'.