Answers

1 (a) Trailer plc

Consolidated Statement of Financial Position at 31 May 2013

	$m
Assets:	
Non-current assets:	
Property, plant and equipment (W9)	3,780·58
Goodwill (W2)	398
Financial assets (W8)	480·77
Current assets (W13)	1,726
Total assets	6,385·35
Equity and liabilities	
Equity attributable to owners of parent	
Share capital	1,750
Retained earnings (W4)	1,254·65
Other components of equity (W5)	170·1
	3,174·75
Non-controlling interest (W7)	892·6
Total non-current liabilities (W10)	1,906
Current liabilities (W6)	412
Total liabilities	2,318
Total equity and liabilities	6,385·35

Working 1

Park

	$m	$m
Fair value of consideration for 60% interest		1,250
Fair value of identifiable net assets acquired:		
Share capital	1,210	
Retained earnings	650	
OCE	55	
FV adjustment – land (balance)	35	
	1,950 x 60%	(1,170)
Goodwill		80

NCI at acquisition is 40% x $1,950m, i.e. $780m

Working 2

Caller comes under the control of Park on 1 June 2011. The investments occurred on the same day and therefore only one goodwill calculation is required. However, the calculation will occur at the date when Trailer gains control of Park, that is 1 June 2012. The effective interest in Caller by Trailer is 14% plus (60% of 70%), i.e. 56%. The NCI will be 44%.

Caller

	$m	$m
Purchase consideration – Trailer		280
Park – 60% of $1,270m		762
Less fair value of identifiable net assets:		
Share capital	800	
Retained earnings	240	
OCE	70	
FV adjustment – land	40	
	1,150 x 56%	(644)
Goodwill		398

NCI at acquisition is $1,150m x 44%, i.e. $506m

The equity interest in Caller held by Trailer has been revalued at 31 May 2013 from $280 million to $310 million and the profit will have been recognised in profit or loss and hence in retained earnings. This needs to be reversed on consolidation ($30m). The gain of $20 million recognised before Trailer took control of Park remains as the original investment is treated at fair value at the acquisition date as part of the consideration for the control of Caller.

Working 3

Impairment of goodwill

Park

	$m	$m
Goodwill		80
Unrecognised non-controlling interest (40%/60% of $80m)		53·3
Identifiable net assets		
Net assets	2,220	
FV adjustment – land	35	
		2,255
Total		2,388·3
Recoverable amount		(2,088)
Impairment		300·3
Less notional goodwill on NCI		(53·3)
Impairment loss to be allocated		247
Allocated to		
Goodwill		80
PPE		167
Total		247

Total goodwill is therefore only that of Caller, i.e. $398m. The impairment loss relating to the PPE is split between NCI ($66·8m) and retained earnings ($100·2m). As the goodwill relating to the NCI is not recognised, no impairment of goodwill is allocated to the NCI. Thus retained earnings are charged with ($80m + $100·2m), i.e. $180·2m. It is assumed that the recoverable amount includes the investment in Caller.

Working 4

Retained earnings

	$m
Trailer:	
Balance at 31 May 2013	1,240
Reversal of gain on revaluation of investment	(30)
Impairment loss (W3)	(180·2)
Interest charge (W8)	(3·99)
Interest credit (W8)	2·76
Reversal of revaluation loss (W9)	11·58
Provision for restructuring (W11)	(14)
Pension plan (W12)	(1·1)
Post-acquisition reserves: Park (60% of (930 – 650))	168
Caller (56% of (350 – 240))	61·6
	1,254·65

Working 5

Other components of equity

	$m
Balance at 31 May 2013 – Trailer	125
Revaluation gain (W9)	21
Pension plan remeasurements (W12)	(4·9)
Park post acquisition (60% of 80 – 55)	15
Caller (56% x (95 – 70))	14
	170·1

Working 6

Current liabilities

	$m
Balance at 31 May 2013	
Trailer	115
Park	87
Caller	196
Provision for restructuring (W11)	14
	412

Working 7

Non-controlling interest

	$m
Park (W1)	780
Caller (W2)	506
Post-acquisition retained earnings – Park (40% of 930 – 650)	112
Post-acquisition retained earnings – Caller (44% of 350 – 240)	48·4
OCE – post acquisition – Park (40% of 80 – 55)	10
OCE – post acquisition – Caller (44% of 95 – 70)	11
Less impairment in Park (W3)	(66·8)
Less NCI share of Park's investment in Caller (40% of $1,270m)	(508)
	892·6

Working 8

The discounted interest rate should be recognised as a reduction in the fair value of the asset when measured for the first time. The treatment reflects the economic substance of the transaction, i.e. Trailer is locking itself into an arrangement where it will incur an effective loss on interest receivable over the life of the instrument. This loss will be anticipated by calculating the present value of all future cash receipts using the prevailing market interest rate for a similar instrument. This will result in a lower figure for fair value than the amount advanced, the difference being required to be debited to profit or loss.

Financial assets – advance

	$m – cash flows	Discount factor	Present value
Advance	50		
2013	(1·5)	0·94	(1·41)
2014	(1·5)	0·89	(1·34)
2015	(51·5)	0·84	(43·26)
			46·01

The initial fair value of the loan is calculated by scheduling the cash flows due to take place over the life of the loan (after the advance has been made) and discounting them to present value using the unsubsidised rate of interest. The making of the loan would be accounted for by:

Dr Financial assets	$46·01m
Cr Cash	$50m
Dr Profit or loss	$3·99m

The accounting entries should be for the year ended 31 May 2013:

Financial assets

Amortised cost at 1 June 2012 $m	Interest credit $m	Cash paid $m	Amortised cost at 31 May 2013 $m
46·01	2·76	(1·5)	47·27

The correcting entries should therefore be:

Dr Retained earnings	$3·99m
Cr Financial asset	$3·99m
Dr Financial asset	$2·76m
Cr Retained earnings	$2·76m

Financial assets

	$m	$m
Trailer	320	
Park	21	
Caller	141	
		482
Interest charge	(3·99)	
Interest credit	2·76	
		(1·23)
Balance at 31 May 2013		480·77

Working 9

Property, plant and equipment

	$m	$m
Trailer	1,440	
Park	1,100	
Caller	1,300	
		3,840
Increase in value of land – Park (W1)		35
Increase in value of land – Caller (W2)		40
Impairment (W3)		(167)
Increase in value of offices		32·58
		3,780·58

In 2012, Trailer would have charged $3m for depreciation ($90m divided by 30). Trailer would then have accounted for the remaining $12m of the $15m fall in value as a revaluation loss and charged this to profit or loss.

In 2013, Trailer should charge depreciation of $2·58m ($75m divided by 29 years – the remaining useful life), reducing the carrying amount of the asset to $72·42m. In order to bring the asset up to its current value of $105m at the end of the year, a revaluation gain of $32·58m needs to be recognised.

The entries will be:

Dr Property, plant and equipment	$32·58m
Cr Profit or loss	$11·58m
Cr Revaluation reserve	$21m

The credit to profit or loss is made up of a reversal of $12m impairment loss charged in 2012, less $0·42m for the depreciation that would have been charged if the asset had not been devalued ($12m divided by 29). This leaves $21m of the upward valuation to be credited to the revaluation reserve.

Working 10

Non-current liabilities

	$m
Trailer	985
Park	765
Caller	150
Defined benefit liability (W12)	6
	1,906

Working 11

Provision for restructuring

Only those costs that result directly from and are necessarily entailed by the restructuring may be included, such as employee redundancy costs or lease termination costs. Expenses that relate to ongoing activities, such as relocation and retraining are excluded. With regard to the service reduction, a provision should be recognised for the redundancy and lease termination costs of $14 million. The sites and details of the redundancy costs have been identified.

In contrast, Trailer should not recognise a provision for the finance and IT department's re-organisation. The re-organisation is not due to start for two years. External parties are unlikely to have a valid expectation that management is committed to the re-organisation as the time frame allows significant opportunities for management to change the details of the plan or even to decide not to proceed with it. Additionally, the degree of identification of the staff to lose their jobs is not sufficiently detailed to support the recognising of a redundancy provision.

Working 12

Pension plan

	$m
Fair value at 1 June 2012	28
Return on plan assets (5% of $28m)	1·4
Contributions for period	2
Benefits paid	(3)
Expected fair value at 31 May 2013	28·4
Actual fair value	29
Remeasurements – gain recognised in OCI	0·6
Obligation at 1 June 2012	30
Interest cost (5% of $30m)	1·5
Current service cost	1
Benefits paid	(3)
Expected obligation	29·5
Obligation at 31 May 2013	35
Remeasurements – loss recognised in OCI	5·5

The liability recognised in the financial statements will be ($35 – $29m), i.e. $6 million.

	$m
Net obligation at 1 June 2012 ($30m – $28m)	2
Net interest cost ($1·5m – $1·4m)	0·1
Contributions	(2)
Current service cost	1
Remeasurement loss ($5·5m – $0·6m)	4·9
Net obligation at 31 May 2013 ($35m – $29m)	6

The current service cost and net interest cost will be charged to profit or loss ($1·1m) and the remeasurements to OCI ($4·9m). There will be no adjustment for the contributions, which have already been taken into account. Therefore the obligation will be credited with $6m.

Working 13

Current assets

	$m
Trailer	895
Park	681
Caller	150
	1,726

(b) IFRS 10 *Consolidated Financial Statements* and FRS 2 *Accounting for Subsidiary Undertakings* provide similar guidance on the preparation of consolidated financial statements. While the detailed conditions for exemption from preparing consolidated financial statements differ between FRS 2 (which is based on the EC (Companies: Group Accounts) Regulations 1992) and IFRS 10, for companies preparing financial statements under EU-adopted IFRS (rather than as issued by the IASB) the requirements to prepare consolidated financial statements are as set out in company law. The determination of whether or not entities are consolidated by a reporting entity is based on control, although some differences exist in the definition of control. This difference in definition will often not result in a practical effect.

Under both IFRS 10 and FRS 2, a subsidiary's financial statements should be prepared using consistent accounting policies and as of the same date as the financial statements of the parent unless it is impracticable to do so. The basic consolidation procedures are also similar under the two standards.

The policy adopted by an entity on initial recognition of NCI is either to fair value the NCI interests or account for the NCI's proportionate share of the fair value of the identifiable net assets. The choice is made on a transaction-by-transaction basis. Under RoI GAAP, there is no option to fair value NCI (minority interest) at the time of acquisition and changes in equity allocated to NCI are determined based on present ownership interest.

Under IFRS, where there is a reduction in the ownership without losing control, the carrying amounts of the controlling and NCI are adjusted to reflect the changes in their relative ownership interests in the subsidiary. Any difference between such amount and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent. Under RoI GAAP, the difference between the carrying amount of the subsidiary's net assets (including any unamortised goodwill) attributable to the group's interest before and after the reduction, together with any proceeds received, are recognised in the group profit or loss.

Under IFRS, where there is a loss of control in the subsidiary, a gain or loss is recognised as the net effect of:

(i) The carrying amount of the subsidiary's net assets including goodwill;
(ii) The carrying amount of any non-controlling interest;
(iii) Fair value of any investment retained as at date of loss of control; and
(iv) Any gains and losses reclassified to profit or loss from OCI (including exchange differences).

Under RoI GAAP, the gain or loss on disposal is calculated by comparing the carrying amount of the group's share of the net assets of the subsidiary undertaking (including unamortised goodwill and goodwill previously eliminated against reserves) before disposal with any remaining carrying amount attributable to the group's interest after the cessation, together with any proceeds received.

IFRS 3 *Business Combinations* and FRS 7 *Fair Values in Acquisition Accounting* provide guidance on how the fair values of assets acquired and liabilities assumed should be determined, although these are not the same. One of the key principles of RoI GAAP is that intangible assets must be separable in the context of identifiable assets and liabilities. Additionally under FRS 10 *Goodwill and Intangible Assests*, goodwill should be capitalised and amortised usually over a period not exceeding 20 years with impairment reviews to confirm the current value. Amortisation, in this way, is not permitted under IFRS.

Both RoI GAAP and IFRS permit an investigation period before the fair value exercise must be finalised, although the length differs, as does the treatment of changes to fair values of assets and liabilities.

Under IFRS, contingent consideration is initially measured at fair value and any subsequent changes are recognised in either profit or loss, or OCI currently. Contingent consideration meeting the definition of equity is not remeasured. Under RoI GAAP, contingent consideration is measured at fair value with any subsequent adjustments made against goodwill.

Under IFRS, an acquirer must expense acquisition-related costs in the periods in which the costs are incurred, except for costs to issue debt or equity securities. Under RoI GAAP, all fees and similar incremental costs incurred directly in making an acquisition (except for the issue costs of shares or other securities) are included in the cost of acquisition.

The recognition of a bargain purchase is different under the two GAAPs. Under IFRS, the excess of the fair value of identifiable assets, liabilities and contingent liabilities over the consideration (i.e. negative goodwill) is recognised immediately through profit or loss. Under RoI GAAP, negative goodwill is capitalised and recognised in profit or loss in the periods in which the non-monetary assets are recovered through depreciation and sale. Negative goodwill in excess of the fair value of the non-monetary assets is recognised in the periods expected to benefit. Where the acquisition is achieved in stages, the acquirer remeasures its previously held equity interest in the acquiree at its acquisition-date fair value and recognises the resulting gain or loss, if any, in profit or loss. Any amounts previously recognised through OCI are recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest. Under RoI GAAP, the cost of acquisition is the total of the costs of the interests acquired, determined as at the date of each transaction. Where the fair values of identifiable assets and liabilities recognised as part of the earlier transaction are reassessed compared to their carrying amounts, a revaluation gain is recognised in the STRGL.

(c) There are several reasons why an accountant should study ethics. The moral beliefs that an individual holds may not be sufficient because often these are simple beliefs about complex issues. The study of ethics can sort out these complex issues by teaching the principles that are operating in these cases. Often there may be ethical principles which conflict and it may be difficult to decide on a course of action. The study of ethics can help by developing ethical reasoning in accountants by providing insight into how to deal with conflicting principles and why a certain course of action is desirable. Individuals may hold inadequate beliefs or hold on to inadequate ethical values. For example, it may be thought that it is acceptable to hold shares in client companies for business reasons, which, of course, is contrary to ethical guidance. Additionally, compliance with GAAP could be thought to be sufficient to meet the duty of an accountant. However, it can be argued that an accountant has an ethical obligation to encourage a more realistic financial picture by applying ethical judgement to the provisions of GAAP.

Another important reason to study ethics is to understand the nature of one's own opinion and ethical values. Ethical principles should be compatible with other values in life. For example, one's reaction to the following circumstances: the choice between keeping your job and violating professional and ethical responsibilities, the resolution of conflicts of interest if they involve family.

Finally, a good reason for studying ethics is to identify the basic ethical principles that should be applied. This will involve not only code-based decisions but also the application of principles that should enable the determination of what should be done in a given situation. The ethical guidance gives a checklist to be applied so that the outcome can be determined. Ethical issues are becoming more and more complex and it is critical to have knowledge of the underlying structure of ethical reasoning. Professional ethics is an inherent part of the profession. ACCA's *Code of Ethics and Conduct* requires its members to adhere to a set of fundamental principles in the course of their professional duty, such as confidentiality, objectivity, professional behaviour, integrity and professional competence and due care. The main aim of professional ethics is to serve as a moral guideline for professional accountants. By referring back to the set of ethical guidelines, the accountant is able to decide on the most appropriate course of action, which will be in line with the professional body's stance on ethics. The presence of a code of ethics is a form of declaration by the professional body to the public that it is committed to ensuring the highest level of professionalism amongst its members.

Although the takeover does not benefit the company, its executives or society as a whole, the action is deceptive, unethical and hence unfair. It violates the relationship of trust, which the company has with society and the professional code of ethics. There are nothing but good reasons against the false disclosure of profits.

2 (a) IFRS 8 *Operating Segments* states that reportable segments are those operating segments or aggregations of operating segments for which segment information must be separately reported. Aggregation of one or more operating segments into a single reportable segment is permitted (but not required) where certain conditions are met, the principal condition being that the operating segments should have similar economic characteristics. The segments must be similar in each of the following respects:

- the nature of the products and services
- the nature of the production processes
- the type or class of customer
- the methods used to distribute their products or provide their services
- the nature of the regulatory environment.

Segments 1 and 2 have different customers. In view of the fact that the segments have different customers, the two segments do not satisfy one of the aggregation criteria above. The decision to award or withdraw a local train contract rests with the transport authority and not with the end customer, the passenger. In contrast, the decision to withdraw from a route in the inter-city train market would normally rest with Verge but would be largely influenced by the passengers' actions that would lead to the route becoming economically unviable.

In the local train market, contracts are awarded following a competitive tender process, and, consequently, there is no exposure to passenger revenue risk. The ticket prices paid by passengers are set by a transport authority and not Verge. By contrast, in the inter-city train market, ticket prices are set by Verge and its revenues are, therefore, the fares paid by the passengers travelling on the trains. In this set of circumstances, the company is exposed to passenger revenue risk. This risk would affect the two segments in different ways but generally through the action of the operating segment's customer. Therefore the economic characteristics of the two segments are different and should be reported as separate segments.

(b) Revenue should be measured at the fair value of the consideration received or receivable under IAS 18 *Revenue*. Where the inflow of cash or cash equivalents is deferred, the fair value of the consideration receivable is less than the nominal amount of cash and cash equivalents to be received, and discounting is appropriate. This would occur in this instance as, effectively, Verge is providing interest-free credit to the buyer. Interest must be imputed based on market rates, which in this case is 6%. Recognition, as defined in the IASB *Framework*, means incorporating an item that meets the definition of revenue in the statement of profit or loss when it meets the following criteria:

- it is probable that any future economic benefit associated with the item of revenue will flow to the entity, and
- the amount of revenue can be measured with reliability.

Thus Verge must recognise revenue as work is performed throughout the contract life. Discounting the revenue to reflect the delay in receipt of cash from the customer ensures that the revenue is reported at its fair value. The difference between the discounted revenue and the payment received should be recognised as interest income.

The calculation of the revenue's fair value is as follows:

In the year ended 31 March 2012, Verge should have recorded revenue of $1·8 million/1·06/1·06, i.e. $1·6 million plus $1 million, i.e. $2·6 million. In the year ended 31 March 2013, revenue should be recorded of $1·2 million/1·06, i.e. $1·13 million. In addition, there will be an interest income of $1·6 million x 6%, i.e. $96,000 recorded in the year to 31 March 2013 which is the unwinding of the discount on the recognised revenue for the year ended 31 March 2012.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- was available when financial statements for those periods were authorised for issue; and
- could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts and fraud. The fact that Verge only included $1 million of the revenue in the financial statements for the year ended 31 March 2012 is a prior period error.

Verge should correct the prior period errors retrospectively in the financial statements for the year ended 31 March 2013 by restating the comparative amounts for the prior period presented in which the error occurred.

(c) Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an entity must recognise a provision if, and only:

- if a present obligation (legal or constructive) has arisen as a result of a past event (the obligating event),
- payment is probable ('more likely than not'), and
- the amount can be estimated reliably.

An obligating event is an event that creates a legal or constructive obligation and, therefore, results in an entity having no realistic alternative but to settle the obligation. The obligating event took place in the year to 31 March 2012. A provision should be made on the date of the obligating event, which is the date on which the event takes place that results in an entity having no realistic alternative to settling the legal or constructive obligation. Even in the absence of legal proceedings, Verge should prudently recognise an obligation to pay damages, but it is reasonable at 31 March 2012 to assess the need for a provision to be immaterial as no legal proceedings have been started and the damage to the building seemed superficial. Provisions should represent the best estimate at the financial statement date of the expenditure required to settle the present obligation and this measurement should take into account the risks and uncertainties of circumstances relevant to the obligation.

In the year to 31 March 2013, as a result of the legal arguments supporting the action, Verge will have to reassess its estimate of the likely damages and a provision is needed, based on the advice that it has regarding the likely settlement. Provisions should be reviewed at each year end for material changes to the best estimate.

Dr Profit or loss	$800,000
Cr Provision for damages	$800,000

The potential for reimbursements (e.g. insurance payments) to cover some of the expenditure required to settle a provision can be recognised, but only if receipt is virtually certain if the entity settles the obligation. IAS 37 requires that the reimbursement be treated as a separate asset. The amount recognised for the reimbursement cannot exceed the amount of the provision. IAS 37 permits the expense relating to a provision to be presented net of the amount. The company seems confident that it will satisfy the terms of the insurance policy and should accrue for the reimbursement:

Dr Trade receivables	$200,000
Cr Profit or loss	$200,000

The court case was found against Verge but as this was after the authorisation of the financial statements, there is no adjustment of the provision at 31 March 2013. It is not an adjusting event.

(d) In accordance with IAS 1 *Presentation of Financial Statements*, all items of income and expense recognised in a period should be included in profit or loss for the period unless a standard or interpretation requires or permits otherwise.

IAS 16 *Property, Plant and Equipment* states that the recognition criteria for PPE are based on the probability that future benefits will flow to the entity from the asset and that cost can be measured reliably. The above normally occurs when the risks and rewards of the asset have passed to the entity. Normally the risks and rewards are assumed to transfer when an unconditional and irrevocable contract is put in place.

Therefore at 31 March 2012, the building would not be recognised as the 'contract' is not unconditional and possession of the building has not been taken by Verge.

Once the conditions of the donated asset have been met in February 2013, the income of $1·5 million is recognised in the statement of profit or loss and other comprehensive income. The following transactions need to be made to recognise the asset in the entity's statement of financial position as of 31 March 2013.

Dr Property, plant and equipment	$2·5m
Cr Profit or loss	$1·5m
Cr Cash/trade payable	$1m

Depreciation of the building should also be charged for the period according to Verge's accounting policy.

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* states that a government grant is recognised only when there is reasonable assurance that (a) the entity will comply with any conditions attached to the grant and (b) the grant will be received. Thus in this case the grant will be recognised.

The grant is recognised as income over the period necessary to match it with the related costs, for which it is intended to compensate, on a systematic basis. A grant receivable as compensation for costs already incurred or for immediate financial support, with no future related costs, should be recognised as income in the period in which it is receivable.

A grant relating to assets (capital based grant) may be presented in one of two ways:

– either as deferred income, or
– by deducting the grant from the asset's carrying amount.

The grant of $250,000 relates to capital expenditure and revenue. It seems appropriate to account for the grant on the basis of matching the grant to the expenditure. Therefore $100,000 (20 x $5,000) should be taken to income and the remainder ($150,000) should be recognised as a capital based grant. The double entry would be:

Dr Cash	$250,000
Cr Profit or loss	$100,000
Cr Deferred income or PPE (depending on accounting policy)	$150,000

3 (a) (i) The lease of the land is subject to the general lease classification criteria of IAS 17 *Leases* and the fact that land normally has an indefinite economic life is an important consideration. Thus, if the lease of land transfers substantially all the risks and rewards incidental to ownership to the lessee, then the lease is a finance lease, otherwise it is an operating lease. A lease of land with a long term may be classified as a finance lease even if the title does not pass to the lessee. Situations set out in IAS 17 that would normally lead to a lease being classified as a finance lease include the following:

(1) the lease transfers ownership of the asset to the lessee by the end of the lease term

(2) the lease term is for the major part of the economic life of the asset, even if title is not transferred

(3) at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset

(4) the lessee has the ability to continue to lease for a secondary period at a rent that is substantially lower than market rent.

A contingent rent is an amount that is paid as part of the lease payments but is not fixed or agreed in advance at the inception of the lease, rather the amount to be paid is dependent on some future event. However, it is not an interest payment, as it is not connected with the passage of time, therefore time value of money is not an issue. Under IAS 17, contingent rents are excluded from minimum lease payments and are accounted as expense/income in the period in which they are incurred/earned. Contingent rents may indicate that a lease is an operating lease if the nature of the contingency provides evidence that the lessor has not transferred substantially all of the risks and rewards of ownership of the land. However, other factors have to be taken into account besides the contingent rental.

The presence of an option to extend the lease at substantially less than a market rent or purchase it at a discount of 90% on the market value implies that the lessor expects to achieve its return on investment mainly through the lease payments and therefore is content to continue the lease for a secondary period at an immaterial rental or sell it at a substantial discount to the market value. This is an indicator of a finance lease. It is reasonable to assume that the lessee will extend the lease in these circumstances. However, an option to extend it at a market rental without the purchase provision may indicate that the lessor has not achieved its return on investment through the lease rentals and therefore is relying on a subsequent lease or sale to do so. This is an indicator of an operating lease as there will be no compelling commercial reason why the lessee should extend the agreement. In this case, the lease term is not for the major part of the economic life of the asset as the asset is land. However, it would appear that the minimum lease payments would equate to the fair value of the asset, given the fact that the lease premium is 70% of the current fair value and the rent is 4% of the fair value for 30 years. Additionally, if land values rise, then there is a revision of the rental every five years to ensure that the lessor achieves the return on the investment. As a result of the above, it would appear that the lease is a finance lease. The upfront premium plus the present value of the annual payments at the commencement of the lease would be capitalised as property, plant and equipment and the annual lease payments would be shown as a liability. The interest expense would be recognised over the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Additionally, Janne plans to use the land in its business but may hold the land for capital gain. Thus the lease may meet the definition of an investment property if it is to be held for capital gain. In the latter case, IAS 40 *Investment Property* should be used to account for the land with the lessee's chosen model used to account for it.

If a lease contains a clean break clause, where the lessee is free to walk away from the lease agreement after a certain time without penalty, then the lease term for accounting purposes will normally be the period between the commencement of the lease and the earliest point at which the break option is exercisable by the lessee. If a lease contains an early termination clause that requires the lessee to make a termination payment to compensate the lessor such that the recovery of the lessor's remaining investment in the lease is assured, then the termination clause would normally be disregarded in determining the lease term. However, the suggestions made by Maret do add substance to the conclusion that the lease is a finance lease, as the early termination clause requires a payment which recovers the lessor's investment and it would appear that Maret is happy to allow the termination of the agreement after 25 years which would imply that the lessor's return would have been achieved after that period of time.

(ii) Under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, a disposal group is classified as held for sale where its carrying amount will be recovered principally through sale rather than continuing use. The sale should be expected to be complete within one year from the date of classification. A disposal group can, exceptionally, be classified as held for sale/discontinued after a period of 12 months if it meets certain criteria. These are: that during the initial one-year period, circumstances arose that were previously considered unlikely and, as a result, a disposal group previously classified as held for sale is not sold by the end of that period. Also during the initial one-year period, the entity took action necessary to respond to the change in circumstances such that the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and the criteria for classification as held for sale are met.

The draft agreements with investment bankers appear not to be sufficiently detailed to prove that the subsidiary met the criteria at the point of classification as required by IFRS 5. This requires the disposal group to be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such disposal groups. Also, Janne had made certain organisational changes during the year to 31 May 2013, which resulted in additional activities being transferred to the subsidiary. This confirms that the subsidiary was not available for sale in its present condition as at the point of classification. Also, the shareholders' authorisation to sell the subsidiary was only granted for one year and there is no indication that this was extended by the subsequent shareholders' meeting in 2013. The subsidiary should have been treated as a continuing operation in the financial statements for both years ended 31 May 2012 and 31 May 2013.

(b) RoI GAAP would consider a similar list of indicators for the determination of a finance lease, but has a rebuttable presumption that transfer of risks and rewards occurs, if the present value of the minimum lease payments discounted at the interest rate implicit in the lease amounts to substantially all (normally 90% or more) of the fair value of the leased asset. IAS 17 *Leases* includes a number of situations that individually or in combination would lead to a lease being classified as a finance lease but there is no 90% test rule.

Lease classification, under IAS 17, is made at the inception of the lease, which is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. Under RoI GAAP, inception is the earlier of the time the asset is brought into use and the date from which rentals first accrue.

A leased asset, under IAS 17, is recognised at the lower of the fair value of the asset or the present value of the minimum lease payments, discounted at the interest rate implicit in the lease or, if this is not available, the entity's incremental borrowing rate. A leased asset, under RoI GAAP, is recognised at the present value of the minimum lease payments, discounted at the interest rate implicit in the lease (or at the borrowing rate on a similar lease), or at the fair value of the asset if it is a sufficiently close approximation of the present value of the minimum lease payments. There is no guidance on treatment of contingent rent under RoI GAAP and the interest rate implicit in the lease excludes the impact of initial direct costs of the lessor but under IAS 17 it includes these costs.

There are no detailed rules regarding the allocation between land and buildings elements under RoI GAAP but, in the context of the Irish property market, only those leases of land and buildings that are of such length that they allow the lessee to redevelop the site are likely to include a significant value for the land element. Under IAS 17, when a lease includes land and buildings elements, the classification of each element as a finance or operating lease is assessed separately. An important consideration is that land normally has an indefinite economic life. The minimum lease payments are allocated between land and buildings in proportion to the relative fair values of the interests in each element. As Janne is only leasing the land, the difference in treatment should not affect the accounting for the lease.

4 (a) (i) Excessive disclosure can obscure relevant information and make it harder for users to find the key points about the performance of the business and its prospects for long-term success. It is important that financial statements are relevant, reliable and can be understood. Additionally, it is important for the efficient operation of the capital markets that annual reports do not contain unnecessary information. However, it is equally important that useful information is presented in a coherent way so that users can find what they are looking for and gain an understanding of the company's business and the opportunities, risks and constraints that it faces. A company, however, must treat all of its shareholders equally in the provision of information. It is for each shareholder to decide whether they wish to make use of that information. It is not for a company to pre-empt a shareholder's rights in this regard by withholding the information.

A significant cause of excessive disclosure in annual reports is the vast array of requirements imposed by laws, regulations and financial reporting standards. Regulators and standard setters have a key role to play in cutting clutter, both by cutting the requirements that they themselves already impose and by guarding against the imposition of unnecessary new disclosures. A listed company may have to comply with listing rules, company law, international financial reporting standards, the corporate governance codes and, if it has an overseas listing, any local requirements, such as those of the SEC in the US. Thus a major source of excessive disclosure is the fact that different parties require differing disclosures for the same matter. For example, an international bank in the RoI may have to disclose credit risk under IFRS 7 *Financial Instruments: Disclosures*, the Companies Acts and the Disclosure and Transparency Rules, the SEC rules and Industry Guide 3 as well as the requirements of Basel II Pillar 3. A problem is that different regulators have different audiences in mind for the requirements they impose on annual reports. Regulators attempt to reach wider ranges of actual or potential users and this can lead to a loss of focus and structure in reports.

Shareholders are increasingly unhappy with the substantial increase in the length of reports that has occurred in recent years. This, often, has not resulted in better information but more confusion as to the reason for the disclosure. A review of companies' published accounts will show that large sections such as 'Statement of Directors Responsibilities' and 'Audit Committee report' can be almost identical.

Preparers now have to consider many other stakeholders including employees, unions, environmentalists, suppliers, customers, etc. The disclosures required to meet the needs of this wider audience have contributed to the increased volume of disclosure. The growth of previous initiatives on going concern, sustainability, risk, the business model and others that have been identified by regulators as 'key' has also expanded the annual report size.

A problem that seems to exist is that disclosures are being made because a disclosure checklist suggests it may need to be made, without assessing whether the disclosure is necessary in a company's particular circumstances. It is inherent in these checklists that they include all possible disclosures that could be material.

The length of the annual report is not necessarily the problem but the way in which it is organised. The inclusion of 'immaterial' disclosures will usually make this problem worse but, in a well organised annual report, users will often be able to bypass much of the information they consider unimportant especially if the report is online. It is not the length of the accounting policies disclosure that is itself problematic, but the fact that new or amended policies can be obscured in a long note running over several pages. A further problem is that accounting policy disclosure is often 'boilerplate', providing little specific detail of how companies apply their general policies to particular transactions. Many disclosure requirements have been introduced in new or revised international accounting standards over the last ten years without any review of their overall impact on the length or usefulness of the resulting financial statements.

(ii) There are behavioural barriers to reducing disclosure. It may be that the threat of criticism or litigation could be a considerable limitation on the ability to cut disclosure. The threat of future litigation may outweigh any benefits to be obtained from eliminating 'catch-all' disclosures. Preparers of annual reports are likely to err on the side of caution and include more detailed disclosures than are strictly necessary to avoid challenge from auditors and regulators. Removing disclosures is perceived as creating a risk of adverse comment and regulatory challenge. Disclosure is the safest option and is therefore often the default position. Preparers and auditors may be reluctant to change from the current position unless the risk of regulatory challenge is reduced. The prospect of internal firm review and/or external review can induce auditors to take a 'tick-box' compliance approach to avoid challenge and adverse publicity. Companies have a tendency to repeat disclosures because they were there last year. Preparers wish to present balanced and sufficiently informative disclosures and may be unwilling to change.

A reassessment of the whole model will take time and may necessitate changes to law and other requirements. The IASB has recently issued a request for views regarding its forward agenda in which it acknowledges that stakeholders have said that disclosure requirements are too voluminous and not always focused in the right areas. The drive by the IASB has very much been to increase the use of disclosure to address comparability between companies and, in the short to medium term, a reduction in the volume of accounting disclosures does not look feasible although this is an area to be considered by the IASB for its post-2012 agenda.

(b) (i) Lizzer's perception of who could reasonably be considered to be among the users of its financial statements is too narrow, being limited to the company's shareholders rather than including debt-holders; and the risk disclosures required by IFRS 7 should be enhanced to include those relating to the debt-holders, by individual series of debt where practicable, so as to ensure that significant differences between the various series of debt are not obscured. IAS 1 states that the objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. The standard also states that omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements.

The objective of IFRS 7 is to require entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments for the entity's financial position and performance. IFRS 7 states that, amongst other matters, for each type of risk arising from financial instruments, an entity shall disclose:

(a) the exposures to risk and how they arise;
(b) its objectives, policies and processes for managing the risk and the methods used to measure the risk.

Thus the risks attached to the debt should be disclosed.

(ii) Lizzer should have disclosed additional information about the covenants relating to each loan or group of loans, including the amount of headroom, as deemed appropriate under IFRS 7. The subsequent breach of the covenants represented a material event after the reporting period and should have given rise to relevant disclosures required by IAS 10 *Events After the Reporting Period* in relation to material non-adjusting events after the reporting period.

According to IFRS 7, an entity should disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period. Disclosure of information about covenants is necessary to a greater extent in situations where the entity is close to breaching its covenants, and in situations where uncertainty is expressed in relation to the going concern assumption. Given the fact that, at 31 January 2013, there was a considerable risk of breach of covenants in the near future, Lizzer should have given additional information relating to the conditions attached to its loans, including details on how close the entity was to breaching the covenants.

A breach of covenants after the date of the financial statements, but before the financial statements were authorised for issue, constitutes a material non-adjusting event after the end of the reporting period which requires further disclosure in accordance with IAS 10. Additionally, there appears to be an apparent inconsistency between the information provided in the directors' and auditors' reports and that which is included in the financial statements. If balances are affected in the SOFP, then there would need to be some adjustment.

			Marks
1	**(a)**	Property, plant and equipment	5
		Goodwill	6
		Financial assets	5
		Current assets/total non-current liabilities	1
		Retained earnings	6
		Other components of equity	3
		Non-controlling interest	3
		Current liabilities	1
		Pension plan	5
			35
	(b)	Subjective assessment of discussion	9
	(c)	Subjective assessment – 1 mark per point	6
			50
2	**(a)**	Segment explanation up to	5
	(b)	IAS 18 explanation and calculation	6
	(c)	IAS 37 explanation and calculation	6
	(d)	IAS 1/16/20 explanation and calculation	6
	Professional marks		2
			25
3	**(a)**	**(i)** Leases explanation up to	11
		(ii) IFRS 5 explanation	6
	(b)	Explanation of differences – 2 marks per valid point	6
	Professional marks		2
			25
4	**(a)**	Subjective disclosure	9
		barriers	6
	(b)	Subjective	8
	Professional marks		2
			25