The Sweetening Company case study

Michael (Mike) Wells prepared this case study to support class discussion designed to foster the development of a cohesive understanding of measuring non-financial asset impairments in general purpose financial information in the sugar industry and as a basis for developing capacity to make the judgements necessary to prepare/audit/regulate/analyse such financial information.

The Sweetening Company (Sweetening)[1] was founded by Ms Sweetening, an American 'member' of the Ethiopian diaspora, to advance further the development of the sugar industry in Ethiopia. It prepares its financial statements in accordance with International Financial Reporting Standards.

The early years: 2000 through 2007

On the basis of Ms Sweetening's experience in successfully developing extensive sugar plantations and sugar-milling operations in the Americas, in early 2000 the Ethiopian Government granted Sweetening 50-year land-use rights to 20,000 hectares of undeveloped arable farmland in a commercial agricultural development zone in the lower area of the Beles river.

Sweetening progressively extended its sugar plantations across its land-use right and in 2003 completed the construction of a sugar mill with the capacity to refine the entire forecast sugar production for not only is plantation but also much of the forecast production of the expected expansion of plantations by others in the region.

In 2006 Sweetening completed the construction of an industrial scale dam (hydro-dam) and a complex system of diversion weirs, canals and state-of-the-art irrigation equipment to mainly to enable the irrigation of its sugar plantations and, in particular, to provide a massive store of water for its use in periods of drought. Sweetening also generates hydroelectricity from the hydro-dam mainly to power its extensive irrigation systems and to fuel its power-hungry sugar mill. Excess electricity is fed directly into the local electricity grid. Sweetening is paid a market related price for such electricity.

The diversification period: 2008 through 2012

In 2008, in unrelated developments, Sweetening diversifies and expands its operations by acquiring controlling interests in:

- Wining: a company farming on land adjoining its existing sugar operations, adding an additional 5,000 hectares of sugar plantations, 2,000 hectares of established vineyards and a winery to the group's operations; and
- Brewing: a company in the Ethiopian highlands growing coffee plants for harvesting coffee cherries.

In pricing the Wining acquisition, Sweetening anticipated many synergies in combining its pre-acquisition businesses with Winings businesses. Through 2012 its results exceed its pre-

[1] The names of individuals, entities and places in this case study are fictitious. Any resemblance to people, entities or places is purely coincidental.

acquisition forecasts and the Sweetening Group experiences rapid growth and increasing profitability in all of its businesses.

In 2012 the construction in Addis Ababa of Sweetening's new head office was celebrated by some as an architectural masterpiece and derided by others as an opulent waste of resources.

The declining period: 2012 through 2014

Although the quality and the quantity of the group's sugar and coffee harvests remained strong from 2012 to 2015 the price of raw sugar halved and the price of coffee fell to a third of its 2011 price. Through 2014 only the vineyard, winery and hydro-dam generated steadily increasing profits.

In 2014 the Sweetening group applied early the bearer plant amendments to IAS 16 *Property, Plant and Equipment* and IAS 41 *Agriculture*.

The disastrous year: 2015

Worse still, in 2015 disease caused the Sweetening Group's entire grape crop to fail and considerable expenditure was needed to save the vineyards from destruction. With no other vineyards in the vicinity of the winery, it processed no new grapes in 2015. By employing the expertise of a leading viticulturist from California, Wining expects its vineyards to gradually recover steadily to full capacity over the next four to five years.

As a result of financial strain caused by these unforeseeable events, in November 2015 Sweetening defaulted on an interest payment due to a commercial bank for the debt incurred to fund the building of its hydro-dam. Consequently, the entire capital amount of the loan became repayable immediately. By late January 2016, Sweetening had successfully negotiated an amendment to the loan agreement that forgave interest payment for 2015 and deferred interest payments for 2016 and 2017 in exchange for a 2% increase in the interest rate charged on the loan.

Ms Sweetening actively fulfils the role of Chief Operating Decision Maker (CODM) of the Sweetening Group. In this capacity she receiving information in the following format:

Coffee farming	Sugar		Grapes		Corporate or unallocated
	Sugar farming	Sugar milling	Vinyards	Winery	
ETB'million	ETB'million	ETB'million	ETB'million	ETB'million	ETB'million

Worrying that the price of coffee will fall further, on 31 March 2015 Sweetening enters into fixed-price commodity forward contracts to sell the quantity of the type of dried coffee cherry that its expects to harvest over the next three seasons (ie through December 2017). Some of the contracts must be settled net in cash and others are for physical delivery.

During 2015, the price of dried coffee cherries falls significantly as a result of oversupply. Consequently, an identical new contract through December 2017, entered into on 31 December 2015, would have a significantly lower fixed price. In other words, Sweetening's coffee forward contracts are 'deeply in the money'.

QUESTIONS FOR CLASS DISCUSSION

1. Assume you[2] are in early 2016 considering acquiring some Sweetening shares. What information about its economic phenomena would you consider useful to inform your investment decision?
2. What judgements would Sweetening make in testing its inventories for impaired at 31 December 2015 in accordance with IAS 2 *Inventories*? For example, in determining:
    a. the level of impairment testing; and
    b. the inputs for measuring net realisable value; and
    c. how to take account, if at all, of its vertically-integrated operations.
3. What are the main judgements Sweetening must make when performing impairment tests at 31 December 2015 in accordance with IAS 36 *Impairment of Assets*? For example in determining:
    a. the level of impairment testing;
    b. the inputs to use when measuring value in use;
    c. the model and inputs to those models to use when measuring the fair value of assets or cash-generating units (or possibly collections of cash generating units);
    d. how to take account, if at all, of its vertically-integrated operations; and
    e. which liabilities, if any, to be included in any of its impairment tests.
4. At 31 December 2015, what are the main judgements that Sweetening would make in measuring its liability to the bank and in presenting and disclosing that liability in its financial statements?

[2] You cannot require Sweetening to provide information directly to you and consequently you must rely on its published general purpose financial statements for much of the financial information you need.