

Forensic Financial Accounting Analysis: Examples from the palm oil industry relating to natural capital

Noble Group: IAS 41; IFRS 5, 7, 9, and 13

A complex transaction conducted by Noble Group in 2014 serves as a good case study for understanding multiple accounting standards and how they impact the values recorded in financial statements. Here is a timeline of the events with discussion:

- **2014:** Noble Group stated its intention to divest/sell its interest in NAL Group. A fair value for NAL Group of \$224 million.ⁱ was then recorded in Noble's financial statements as an asset "held for sale." However, Noble Group wanted to retain NAL's palm oil business. In exchange for these palm oil assets the company issued a promissory note/debt of \$64.4 million to NAL Group.ⁱⁱ This promissory note carried a contingent value right under which Noble would remit the proceeds of the sale of palm business, less certain expenses, to the NAL Group once sold.

This transaction falls under multiple accounting standards. First, IFRS 5: Financial reporting for non-current assets held for sale and discontinued operations. This governed the conditions and treatment of the \$224 million of NAL Group assets held for sale.ⁱⁱⁱ Second, IFRS: Financial Instruments, Disclosures dictated that Noble Group disclose the qualitative and quantitative information about the transaction and how it affected the company's risks. Third, IFRS 9 provides the comprehensive technical criteria for reporting the details of financial instruments. Fourth, as discussed in a previous case study, proper fair value accounting is covered by IFRS 13. Last, recall from earlier that IAS 41 dictates how agricultural assets are reported.

- **2016:** Noble Group continued to own NAL Group asset at the end of 2016, reporting it with a fair value of \$228 million in its audited 2016 financial statements.^{iv} This represented a \$4 million increase. Of this \$228 million "asset held for sale," \$197 million was the fair market value of property, plant and equipment (PPE) related to the palm assets.
- **2017:** Noble Group's second quarter report noted a \$60 million "non-cash impairment to non-current assets" on its two palm oil assets held for sale.^v These palm oil assets had been retained by Noble Group as part of its divestiture of NAL Group. This represented a steep decline just two quarters after its recorded value as of the end of 2016.
- **2017:** At the end of 2017, Noble Group recorded the fair value of its PPE related palm assets as \$62 million. This was a decrease of \$135 million from the \$197 million reported at the end of 2016, just one year prior.

Noble Group's Q2 interim impairment of \$60 million explains less than one half of the total impairment experienced between 2016 and 2017.^{vi} Noble Group's annual statement does not explain the additional \$75 million in impairment to its palm oil related PPE.

Furthermore, Noble Group's recognition of impairment occurred only after its creditor HSBC, the Roundtable on Sustainable Palm Oil (RSPO), and others requested that Noble Group review its

valuation of its concessions in West Papua, Indonesia. Of interest to market participants was the fact that Noble Group had stated that one of the plantations – PT Pusaka Agro Lestari, certified to RSPO, was only 11% forested as opposed to actually being 90% forested.^{vii}

As a condition of this RSPO certification was requirement that Noble Group adhere to the RSPO's application of the High Conservation Values, an indirect measure of natural capital, where Noble Group misstated the forested percent in its concession,^{viii,ix,x} contradicting Noble Group's own stated intention from its 2016 Annual Report.^{xi}

Since costs of production increase if an area is forested due to forest clearance costs, market participants wanted to know if the \$228 million reported had factored in the additional costs associated with the increase in forested habitat.

Noble Group's impairment charge of its palm oil related assets calls into question the reliability of its application of IAS 41 in prior years. While write downs are required under IAS 41 to mark biological assets to market, impairment charges caused by factors such as the amount of forest to be cleared are measurable ex ante.

- 2018: These and other accounting irregularities led to Noble Group's shares being suspended from trading in November 2018 from the Singapore Stock Exchange.^{xii} Ultimately, Noble Group would declare it was defaulting on debt obligations and undergo an extensive restructuring process that led to the creation of Noble Group Holdings Ltd.
- 2019: Noble Group finally sold its two palm oil concessions for \$67 million in 2019.^{xiii}

Noble Group's accounting disclosures were poor or non-existent relative to IFRS 5, 7, 9, and 13, as well as IAS 41. Investors relying on these disclosures would have overstated the value of its assets held for sale and undervalued its liabilities on its balance sheet.

References

ⁱ Noble Group (2014). *Annual Report*. P. 118, Note 18.

ⁱⁱ Noble Group (2017). *Annual Report*. P. 139 E2: *Subsidiaries Classified as Held for Sale (i) Palm* and P. 153 F3: Other new and Revised Accounting Standards.

Idem: P. 139.

"As part of the disposal of CAL Group in 2014, the Group retained the palm business in exchange for a promissory note of US\$64,449,000 issued to CAL Group. The promissory note carries a contingent value right, under which the Group shall remit to the CAL Group, the proceeds of the sale of palm business, less any taxes, expenses and other costs of sale, received by the Group from a third party, and the CAL Group shall return the promissory note. As of 31 December 2017, the Group is in discussion with potential buyers on the sale of the palm business. Based on the potential value, the Group assessed the value of promissory note to be zero.

The major classes of assets and liabilities for the business held for sale as of 31 December 2017 and 2016 are stated at the lower of cost and recoverable amount and were as follows:"

Idem: P. 139.

Table Error! Main Document Only.: *Noble Group's Assets in Subsidiaries as Held-for-Sale 2016–2017.*

2017 USD '000

2016 USD '000

Property, Plant and Equipment	\$62,027	\$197,034
Intangible Assets	\$9,461	\$9,461
Agricultural Assets	\$368	\$349
Cash and Cash Equivalents	\$799	\$540
Prepayments, Deposits and Other Receivables	\$18,805	\$17,092
Inventories	\$2,675	\$3,781
Assets in Subsidiaries as Held for Sale	\$94,135	\$228,257

Idem: P. 153

“Impact of other new and revised international financial reporting standards (continued) (c) Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of disclosure requirements in IFRS 12 from Annual Improvements Cycle – 2014-2016.

The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10–B16, apply to an entity’s interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale.

As of December 31, 2017, the Group classified its interest in Palm, NAC and TTY, wholly owned subsidiaries, as held for sale (see Note E2), but these amendments did not affect the Group’s financial statements.”

iii Noble Group (2014). *Annual Report*. P. 118, Note 18.

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^v Noble Group (August 10, 2017). *Interim Results*.

^{vi} Noble Group (August 10, 2017). *Interim Results*.

^{vii} Levicharova, Moulin, and Thoumi, CFA, FRM, Chain Reaction Research (August 2016). *Noble Group: Cost of capital and deforestation risks underpriced?* P. 4.

^{viii} Chain Reaction Research (June 7, 2017). *The Chain: Noble Group's Deforestation Risks Further Sinks the Ship*.

^{ix} There are six recognized forms of High conservation values forests:

- HCV1. Forest areas containing globally, regionally or nationally significant concentrations of biodiversity values (e.g., endemism, endangered species, refugia).
- HCV2. Forest areas containing globally, regionally or nationally significant large landscape level forests, contained within, or containing the management unit, where viable populations of most if not all naturally occurring species exist in natural patterns of distribution and abundance.
- HCV3. Forest areas that are in or contain rare, threatened or endangered ecosystems.
- HCV4. Forest areas that provide basic services of nature in critical situations (e.g., watershed protection, erosion control).
- HCV5. Forest areas fundamental to meeting basic needs of local communities (e.g., subsistence, health).
- HCV6. Forest areas critical to local communities' traditional cultural identity (areas of cultural, ecological, economic or religious significance identified in cooperation with such local communities).

^x Chain Reaction Research (June 7, 2017). *The Chain: Noble Group's Deforestation Risks Further Sinks the Ship*.

Figure 1: Noble Group's PT HIP deforestation, Papua, Indonesia, 2016-Current. Source: Aidenvironment.

^{xi} Noble Group (2016). *Annual Report*. P. 17. "Since 2013, permanent conservation departments at both plantations have been responsible for implementing our integrated conservation master plan. We have published our sustainability criteria to illustrate our approach across critical areas, such as undertaking free, prior and informed consent, assess social and environmental impacts, conservation of forest and high conservation values areas, maintain high carbon stocks areas, no planting on peat and a zero burning policy."

^{xii} Tan, The Business Times (January 17, 2020). *GX RegCo seeks tougher standards for audits and property valuations: Public consultation launched; regulator is also reviewing practices on business valuations*.

^{xiii} Market Screener (May 24, 2019). *Noble: Sale of Palm Oil Plantation Assets*.