
Answers

- 1 (a) Disposal of equity interest in Sijin
 The gain recognised in profit or loss would be as follows:

	\$m
Fair value of consideration	23
Fair value of residual interest	13
Gain reported in comprehensive income	<u>1</u>
	37
<i>less</i> net assets and goodwill derecognised	
net assets	(36)
goodwill (\$39 – \$32 million)	<u>(7)</u>
Loss on disposal	<u>(6)</u>

- (b) Grange plc
 Consolidated Statement of Financial Position at 30 November 2009

	\$m
Assets:	
Non-current assets	
Property, plant and equipment (W6)	784.47
Investment property (W7)	8
Goodwill (30 + 8)	38
Intangible assets (10 – 3)	7
Investment in Associate (Part a)	<u>13</u>
	850.47
Current assets	<u>920</u>
Total assets	<u>1,770.47</u>
Equity and liabilities:	
Share capital	430
Retained earnings (W3)	401.67
Other components of equity (W3)	<u>57.98</u>
	889.65
Non-controlling interest (W5)	<u>140.82</u>
Total equity	<u>1,030.47</u>
Non-current liabilities	<u>334</u>
Current liabilities	
Trade and other payables	354
Provisions for liabilities (W4)	<u>52</u>
Total current liabilities	<u>406</u>
Total liabilities	<u>740</u>
Total equity and liabilities	<u>1,770.47</u>

Working 1 Park goodwill and subsequent acquisition

	\$m	\$m
Fair value of consideration for 60% interest	250	
Fair value of non-controlling interest	<u>150</u>	400
Fair value of identifiable net assets acquired		(360)
Franchise right		<u>(10)</u>
Goodwill		<u>30</u>

Amortisation of Franchise right

1 June 2008 to 30 November 2009 – \$10m divided by five years multiplied by 1.5 years is \$3 million

Dr Profit or loss	\$3 million	
Cr Franchise right	\$3 million	

Acquisition of further interest

The net assets of Park have increased from \$370 million to \$(414 + 5 + 10 - 3) i.e. \$426 million at 30 November 2009. They have increased by \$56 million and therefore the NCI has increased by 40% of \$56 million i.e. \$22.4 million.

	\$m
Park – NCI 1 June 2008	150
Increase in net assets – NCI to 30 November 2009	22.4
	<hr/>
NCI – 30 November 2009	172.4
	<hr/>
Transfer to equity 20/40	(86.2)
	<hr/>
Balance at 30 November 2009	86.2
	<hr/>
Fair value of consideration	90
Transfer from NCI	(86.2)
	<hr/>
Negative movement in equity	3.8

Alternatively the acquisition could have been calculated as consideration of \$90m less 20% of net assets at second acquisition (20% x (net assets per question 414 + land fair value 5 + franchise fair value 10 less franchise amortisation 3)), resulting in a negative movement in equity of \$4.8m. The NCI would therefore be \$85.2 million.

Working 2 Fence goodwill and disposal

	\$m
Fair value of consideration	214
Fair value of net assets held	(202)
Increase in value of PPE	(4)
	<hr/>
Goodwill	8
	<hr/>
Sale of equity interest in Fence	
Fair value of consideration received	80
Amount recognised as non-controlling interest (Net Assets per question at year end 232 – provision created 25 + Fair value of PPE at acquisition 4 – depreciation of fair value adjustment 0.53 (4 x 16/12 x 1/10) + goodwill 8) x 25%	(54.62)
	<hr/>
Positive movement in parent equity	25.38

Because a provisional fair value had been recognised for the non-current asset and the valuation was received within 12 months of the date of the acquisition, the fair value of the net assets at acquisition is adjusted thus affecting goodwill.

Contingent liability – Fence

IFRS 3 (2004) required the contingent liabilities of the acquiree to be recognised and measured in a business combination at acquisition-date fair value. IFRS 3 (2008) effectively reapplies the requirement of IFRS 3 (2004) to measure at acquisition-date fair value regardless of probability, but retains a filter based on whether fair value can be measured reliably. This may result in the recognition of contingent liabilities that would not qualify for recognition under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The following consolidation adjustment would have been made:

Dr Retained earnings	\$30 million
Cr Contingent liability	\$30 million

IFRS 3(2008) requires the acquirer to measure contingent liabilities subsequent to the date of acquisition at the higher of the amount that would be recognised in accordance with IAS 37, and the amount initially recognised, less any appropriate cumulative amortisation. These requirements should be applied only for the period in which the item is considered to be a contingent liability, and usually will result in the contingent liability being carried at the value attributed to it in the initial business combination.

In this case, the contingent liability has subsequently met the requirements to be classified as a provision and has been measured in accordance with IAS 37. As a result the provisions for liabilities of Fence will be reduced by \$5 million as the contingent liability consolidation adjustment is no longer required and the provision is created as an entry in the financial statements of Fence. No adjustment will be made to goodwill arising on acquisition.

Dr Contingent Liability/Provisions	\$5 million
Cr Profit or loss	\$5 million

Working 3 Retained earnings and other components of equity

Retained earnings	\$m
Grange:	
Balance at 30 November 2009	410
Associate profits Sitin (post acquisition profit 3 x 100%)	3
Loss on disposal of Sitin	(6)
Impairment	(28)
Investment property – gain	2
Provision for legal claims	(7)
Post acquisition reserves: Park (60% x (year end retained earnings 170 – acquisition profit 115 – franchise amortisation 3)	31·2
Fence (100% x (year end retained earnings 65 – acquisition retained earnings 73 + conversion of contingent liability to provision and reduction 5 – FV PPE depreciation 0·53))	(3·53)
	<u>401·67</u>

Other components of equity	\$m
Balance at 30 November 2009	22
Post acqn reserves – Park (60% x (14 – 10))	2·4
– Fence (17 – 9)	8
– Sitin (post acquisition 1 – recycled on disposal 1)	(nil)
Revaluation surplus – foreign property	4
Park – negative movement in equity	(3·8)
Fence – positive movement in equity	25·38
	<u>57·98</u>

Working 4 Provisions

	\$m
Balance at 30 November 2009	
Grange	10
Park	6
Fence	4
	<u>20</u>
Contingency	30
Cancellation of contingency and introduction of provision	(5)
Provision for environmental claims	7
	<u>52</u>

Working 5 Non-controlling interest

	\$m
Park (W1)	86·2
Fence (W2)	54·62
Total	<u>140·82</u>

Working 6 Property, plant and equipment

	\$m	\$m
Grange	257	
Park	311	
Fence	238	
	<u>806</u>	
Increase in value of land – Park (360 – 230 – 115 – 10)		5
Investment property – reclassified		(6)
Impairment – Grange (W9)		(28)
Increase in value of PPE – Fence		4
Less: increased depreciation (4 x 16/12 ÷ 10)		(0·53)
Revaluation surplus foreign property		4
		<u>784·47</u>

Working 7

The land should be classified as an investment property. Although Grange has not decided what to do with the land, it is being held for capital appreciation. IAS 40 '*Investment Property*' states that land held for indeterminate future use is an investment property where the entity has not decided that it will use the land as owner occupied or for short-term sale. The land will be measured at fair value as Grange has a policy of maximising its return on capital employed. The fall in value of the investment property after the year-end will not affect its year-end valuation as the uncertainty relating to the regeneration occurred after the year-end.

Dr Investment property	\$6 million
Cr PPE	\$6 million
Dr Investment property	\$2 million
Cr Profit or loss	\$2 million

No depreciation will be charged

Working 8 Provision for environmental claims

The environmental obligations of \$1 million and \$6 million (total \$7 million) arise from past events but the costs of \$4 million relating to the improvement of the manufacturing process relate to the company's future operations and should not be provided for.

Dr Profit or loss	\$7 million
Cr Provision	\$7 million

Working 9 Restructuring

A provision for restructuring should not be recognised, as a constructive obligation does not exist. A constructive obligation arises when an entity both has a detailed formal plan and makes an announcement of the plan to those affected. The events to date do not provide sufficient detail that would permit recognition of a constructive obligation. Therefore no provision for reorganisation should be made and the costs and benefits of the plan should not be taken into account when determining the impairment loss. Any impairment loss can be allocated to non-current assets, as this is the area in which the directors feel that loss has occurred.

	\$m
Carrying value of Grange's net assets	862
Revaluation surplus	4
Provision for legal claims	(7)
Investment property	2
Impairment of investment in Sitin (16 – 13)	(3)
	<hr/>
	858
Value-in-use (pre-restructuring)	830
	<hr/>
Impairment to PPE	(28)
	<hr/>

Working 10 Foreign property

	\$m
Value at 30 November 2009 (12m dinars/1.5)	8
Value at acquisition 30 November 2008	4
	<hr/>
Revaluation surplus to equity	4
	<hr/>
Change in fair value (4m dinars at 1.5)	2.67
Exchange rate change	1.33
	<hr/>
(8m dinars at 2 minus 12 million dinars at 1.5)	4
	<hr/>

- (c) Rules are a very important element of ethics. Usually this means focusing upon the rules contained in the accounting profession's code of professional conduct and references to legislation and corporate codes of conduct. They are an efficient means by which the accounting profession can communicate its expectations as to what behaviour is expected.

A view that equates ethical behaviour with compliance to professional rules could create a narrow perception of what ethical behaviour constitutes. Compliance with rules is not necessarily the same as ethical behaviour. Ethics and rules can be different. Ethical principles and values are used to judge the appropriateness of any rule.

Accountants should have the ability to conclude that a particular rule is inappropriate, unfair, or possibly unethical in any given circumstance. Rules are the starting point for any ethical question and rules are objective measures of ethical standards. In fact, rules are the value judgments as to what is right for accountants and reflect the profession's view about what constitutes good behaviour. Accountants who view ethical issues within this rigid framework are likely to suffer a moral crisis when encountering problems for which there is no readily apparent rule.

An overemphasis on ethical codes of behaviour tends to reinforce a perception of ethics as being punitive and does not promote the positive aspects of ethics that are designed to promote the reputation of an accounting firm and its clients, as well as standards within the profession. The resolution of ethical problems depends on the application of commonly shared ethical principles with appropriate skill and judgment. Ethical behaviour is based on universal principles and reasoned public debate and is difficult to capture in 'rules'.

Accountants have to make accounting policy choices on a regular basis. Stakeholders rely on the information reported by accountants to make informed decisions about the entity at hand. All decisions require judgment, and judgment depends on personal values with the decision needing to be made on some basis such as following rules, obeying authority, caring for others, justice, or whether the choice is right. These values and several others compete as the criterion for making a choice. Such personal values incorporate ethical values that dictate whether any accounting value chosen is a good or poor surrogate for economic value. To maintain the faith of the public, accountants must be highly ethical in their work. The focus on independence (conflict of interest) and associated compliance requirements may absorb considerable resources and conceptual space in relation to ethics in practice. This response is driven by a strong commitment within the firms to meet their statutory and regulatory obligations. The primary focus on independence may have narrowed some firms' appreciation of what constitutes broader ethical performance. As a result it may be that the increasing codification and compliance focus on one or two key aspects of ethical behaviour may be in fact eroding or preventing a more holistic approach to enabling ethics in practice.

If the director tells Field about the liquidity problems of Brook, then a confidence has been betrayed but there is a question of honesty if the true situation is not divulged. Another issue is whether the financial director has a duty to several stakeholders including the shareholders and employees of Grange, as if the information is disclosed about the poor liquidity position of Brook, then the amounts owing to Grange may not be paid. However, there is or may be a duty to disclose all the information to Field but if the information is deemed to be insider information then it should not be disclosed.

The finance director's reputation and career may suffer if Brook goes into liquidation especially as he will be responsible for the amounts owing by Brook. Another issue is whether the friend of the director has the right to expect him to keep the information private and if the shareholders of Grange stand to lose as a result of not divulging the information there may be an expectation that such information should be disclosed. Finally, should Field expect any credit information to be accurate or simply be a note of Brook's credit history? Thus it can be seen that the ethical and moral dilemma's facing the director of Grange are not simply a matter of following rules but are a complex mix of issues concerning trust, duty of care, insider information, confidentiality and morality.

- 2 (a)** IAS 36 '*Impairment of Assets*' states that an asset is impaired when its carrying amount will not be recovered from its continuing use or from its sale. An entity must determine at each reporting date whether there is any indication that an asset is impaired. If an indicator of impairment exists then the asset's recoverable amount must be determined and compared with its carrying amount to assess the amount of any impairment. Accounting for the impairment of non-financial assets can be difficult as IAS 36 '*Impairment of Assets*' is a complex accounting standard. The turbulence in the markets and signs of economic downturn will cause many companies to revisit their business plans and revise financial forecasts. As a result of these changes, there may be significant impairment charges. Indicators of impairment may arise from either the external environment in which the entity operates or from within the entity's own operating environment. Thus the current economic downturn is an obvious indicator of impairment, which may cause the entity to experience significant impairment charges.

Assets should be tested for impairment at as low a level as possible, at individual asset level where possible. However, many assets do not generate cash inflows independently from other assets and such assets will usually be tested within the cash-generating unit (CGU) to which the asset belongs. Cash flow projections should be based on reasonable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. The discount rate used is the rate, which reflects the specific risks of the asset or CGU.

The basic principle is that an asset may not be carried in the statement of financial position at more than its recoverable amount. An asset's recoverable amount is the higher of:

- (a) the amount for which the asset could be sold in an arm's length transaction between knowledgeable and willing parties, net of costs of disposal (fair value less costs to sell); and
- (b) the present value of the future cash flows that are expected to be derived from the asset (value in use). The expected future cash flows include those from the asset's continued use in the business and those from its ultimate disposal. Value in use (VIU) is explicitly based on present value calculations.

This measurement basis reflects the economic decisions that a company's management team makes when assets become impaired from the viewpoint of whether the business is better off disposing of the asset or continuing to use it.

The assumptions used in arriving at the recoverable amount need to be 'reasonable and supportable' regardless of whether impairment calculations are based on fair value less costs to sell or value in use. The acceptable range for such assumptions will change over time and forecasts for revenue growth and profit margins are likely to have fallen in the economic climate. The assumptions made by management should be in line with the assumptions made by industry commentators or analysts. Variances from market will need to be justified and highlighted in financial statement disclosures.

Whatever method is used to calculate the recoverable amount; the value needs to be considered in the light of available market evidence. If other entities in the same sector are taking impairment charges, the absence of an impairment charge have to be justified because the market will be asking the same question.

It is important to inform the market about how it is dealing with the conditions, and be thinking about how different parts of the business are affected, and the market inputs they use in impairment testing. Impairment testing should be commenced as soon as possible as an impairment test process takes a significant amount of time. It includes identifying impairment indicators, assessing or reassessing the cash flows, determining the discount rates, testing the reasonableness of the assumptions and benchmarking the assumptions with the market. Goodwill does not have to be tested for impairment at the year-end; it can be tested earlier and if any impairment indicator arises at the balance sheet date, the impairment assessment can be updated. Also, it is important to comply with all disclosure requirements, such as the discount rate and long-term growth rate assumptions in a discounted cash flow model, and describe what the key assumptions are and what they are based on.

It is important that the cash flows being tested are consistent with the assets being tested. The forecast cash flows should make allowance for investment in working capital if the business is expected to grow. When the detailed calculations have been completed, the company should check that their conclusions make sense by comparison to any market data, such as share prices and analysts reports. Market capitalisation below net asset value is an impairment indicator, and calculations of recoverable amount are required. If the market capitalisation is lower than a value-in-use calculation, then the VIU assumptions may require reassessment. For example, the cash flow projections might not be as expected by the market, and the reasons for this must be scrutinised. Discount rates should be scrutinised in order to see if they are logical. Discount rates may have risen too as risk premiums rise. Many factors affect discount rates in impairment calculations. These include corporate lending rates, cost of capital and risks associated with cash flows, which are all increasing in the current volatile environment and can potentially result in an increase of the discount rate.

- (b) An asset's carrying amount may not be recovered from future business activity. Wherever indicators of impairment exist, a review for impairment should be carried out. Where impairment is identified, a write-down of the carrying value to the recoverable amount should be charged as an immediate expense in the income statement. Using a discount rate of 5%, the value in use of the non-current assets is:

Year to	31 May 2010	31 May 2011	31 May 2012	31 May 2013	Total
Discounted cash flows (\$000)	267	408	431	452	1,558

The carrying value of the non-current assets at 31 May 2009 is \$3 million – depreciation of \$600,000. i.e. \$2.4 million. Therefore the assets are impaired by \$842,000 (\$2.4m – \$1.558m).

IAS 36 requires an assessment at each balance sheet date whether there is an indication that an impairment loss may have decreased. This does not apply to goodwill or to the unwinding of the discount. In this case, the increase in value is due to the unwinding of the discount as the same cash flows have been used in the calculation. Compensation received in the form of reimbursements from governmental indemnities is recorded in the statement of comprehensive income when the compensation becomes receivable according to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. It is treated as separate economic events and accounted for as such. At this time the government has only stated that it may reimburse the company and therefore credit should not be taken of any potential government receipt.

For a revalued asset, the impairment loss is treated as a revaluation decrease. The loss is first set against any revaluation surplus and the balance of the loss is then treated as an expense in profit or loss. The revaluation gain and the impairment loss would be treated as follows:

	Depreciated historical cost (\$m)	Revalued carrying value (\$m)
1 December 2006	10	10
Depreciation (2 years)	(2)	(2)
Revaluation		0.8
1 December 2008	8	8.8
Depreciation	(1)	(1.1)
Impairment loss	(1.5)	(2.2)
30 November 2009 after impairment loss	5.5	5.5

The impairment loss of \$2.2 million is charged to equity until the carrying amount reaches depreciated historical cost and thereafter it goes to profit or loss. It is assumed that the company will transfer an amount from revaluation surplus to retained earnings to cover the excess depreciation of \$0.1 million as allowed by IAS 16. Therefore the impairment loss charged to equity would be \$(0.8 – 0.1) million i.e. \$0.7 million and the remainder of \$1.5 million would be charged to profit or loss.

A plan by management to dispose of an asset or group of assets due to under utilisation is an indicator of impairment. This will usually be well before the held for sale criteria under IFRS 5 '*Non Current Assets Held-for-sale and Discontinued Activities*' are met. Assets or CGUs are tested for impairment when the decision to sell is made. The impairment test is updated immediately before classification under IFRS 5. IFRS 5 requires an asset held for sale to be measured at the lower of its carrying amount and its fair value less costs to sell. Non-current assets held for sale and disposal groups are re-measured at the lower of carrying amount or fair value less costs to sell at every balance sheet date from classification until disposal. The measurement process is similar to that which occurs on classification as held for sale. Any excess of carrying value over fair value less costs to sell is a further impairment loss and is recognised as a loss in the statement of comprehensive income in the current period. Fair value less costs to sell in excess of carrying value is ignored and no gain is recorded on classification. The non-current assets or disposal group cannot be written up past its previous (pre-impairment) carrying amount, adjusted for depreciation, that would have been applied without the impairment. The fact that the asset is being marketed at a price in excess of its fair value may mean that the asset is not available for immediate sale and therefore may not meet the criteria for 'held for sale'.

- 3 (i)** Revenue arising from the sale of goods should be recognised when all of the following criteria have been satisfied: [IAS 18 Para 14]
- The seller has transferred to the buyer the significant risks and rewards of ownership;
 - The seller retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
 - The amount of revenue can be measured reliably;
 - It is probable that the economic benefits associated with the transaction will flow to the seller; and
 - The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Burley should recognise a purchase from Slite for the amount of the excess amount extracted (10,000 barrels x \$100). The substance of the transaction is that Slite has sold the oil to Burley at the point of production at market value at that time. Burley should recognise all of the oil it has sold to the third parties as revenue including that purchased from Slite as the criteria in IAS 18 are met. The amount payable to Slite will change with movements in the oil price. The balance at the year-end is a financial liability, which should reflect the best estimate of the amount of cash payable, which at the year-end would be \$1,050,000. The best estimate will be based on the price of oil on 30 November 2009. At the year-end there will be an expense of \$50,000 as the liability will have increased from \$1 million. The amount payable will be revised after the year-end to reflect changes in the price of oil and would have amounted to \$950,000. Thus giving a gain of \$100,000 to profit or loss in the following accounting period.

Events after the reporting period are events, which could be favourable or unfavourable, and occur between the end of the reporting period and the date that the financial statements are authorised for issue. [IAS 10 Para 3]

An adjusting event is an event after the reporting period that provides further evidence of conditions that existed at the end of the reporting period, including an event that indicates that the going concern assumption in relation to the whole part or part of the enterprise is not appropriate. A non-adjusting event is an event after the reporting period that is indicative of a condition that arose after the end of the reporting period. [IAS 10 Para 3]

Inventories are required to be stated at the lower of cost and net realisable value (NRV). [IAS 2 Para 9] NRV is the estimated selling price in the ordinary course of business, less the estimated cost of completion and the estimated costs necessary to make the sale. Any write-down to NRV should be recognised as an expense in the period in which the write-down occurs. Estimates of NRV are based on the most reliable evidence available at the time the estimates are made. These estimates consider fluctuations in price directly relating to events occurring after the end of the financial period to the extent that they confirm conditions at the end of the accounting period.

Burley should calculate NRV by reference to the market price of oil at the balance sheet date. The price of oil changes frequently in response to many factors and therefore changes in the market price since the balance sheet date reflect events since that date. These represent non-adjusting events. Therefore the decline in the price of oil since the date of the financial statements will not be adjusted in those statements. The inventory will be valued at cost of \$98 per barrel as this is lower than NRV of \$(105 – 2) i.e. \$103 at the year-end.

Workings 1

	DR(\$)	CR(\$)
Purchases/Inventory (10,000 x 100)	1m	
Slite – financial liability		1m
At year end		
Expense	50,000	
Slite – financial liability (10,000 x \$(105 – 100))		50,000
After year end		
Slite – financial liability (10,000 x \$(105 – 95))	100,000	
Profit or loss		100,000
Cash paid to Slite is \$950,000 on 12 December 2009		

- (ii)** A jointly controlled entity is a corporation, partnership, or other entity in which two or more venturers have an interest, under a contractual arrangement that establishes joint control over the entity. [IAS 31.24]

IAS 31 allows two treatments of accounting for an investment in jointly controlled entities:

- Proportionate consolidation.
- Equity method of accounting.

Joint control is the contractually agreed sharing of control over an economic activity and only exists when strategic, financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control i.e. the venturers. [IAS 31 Para 3] Thus Burley cannot use proportionate consolidation, as Wells is not jointly controlled. A decision can be made by gaining the approval of two thirds of the venturers and not by unanimous agreement. Two out of the three venturers can make the decision. Thus each investor must account for their interest in the entity as an associate since they have significant influence but not control. Equity accounting will be used.

One of the key differences between decommissioning costs and other costs of acquisition is the timing of costs. Decommissioning costs will not become payable until some future date. Consequently, there is likely to be uncertainty over the amount of costs that will be incurred. Management should record its best estimate of the entity's obligations. [IAS 16.16]

Discounting is used to address the impact of the delayed cash flows. The amount capitalised, as part of the assets will be the amount estimated to be paid, discounted to the date of initial recognition. The related credit is recognised in provisions. An entity that uses the cost model records changes in the existing liability and changes in discount rate are added to, or deducted from, the cost of the related asset in the current period. [IFRIC 1.5]

Thus in the case of Wells, the accounting for the decommissioning is as follows.

The carrying amount of the asset will be

	\$m
Carrying amount at 1 December 2008	
(240 – depreciation 60 – 14.1 decrease	
In decommissioning costs)	165.9
Less depreciation 165.9 ÷ 30 years	(5.5)
Carrying amount at 30 November 2009	<u>160.4</u>
Finance cost (\$32.6 million – \$14.1 million) at 7%	1.3
Decommissioning liability will be (\$32.6m – \$14.1m)	<u>18.5</u>
Decommissioning liability at 30 November 2009	<u>19.8</u>

Jointly controlled assets involve the joint control, and often the joint ownership, of assets dedicated to the joint venture. Each venturer may take a share of the output from the assets and each bears a share of the expenses incurred. [IAS 31 Para 18]

IAS 31 requires that the venturer should recognise in its financial statements its share of the joint assets, any liabilities that it has incurred directly and its share of any liabilities incurred jointly with other venturers, income from the sale or use of its share of the output of the joint venture, its share of expenses incurred by the joint venture and expenses incurred directly in the respect of its interest in the joint venture. [IAS 31 Para 21] The pipeline is a jointly controlled asset. Therefore, Burley should not show the asset as an investment but as property, plant and equipment. Any liabilities or expenses incurred should be shown also.

- (iii) An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise. [Framework. Para 49(a)] An asset is recognised in the statement of financial position when it is probable that the future economic benefits will flow to the enterprise and the asset has a cost or value that can be measured reliably. [Framework. Para 89]

IAS 38 '*Intangible Assets*' also requires an enterprise to recognise an intangible asset, whether purchased or self-created (at cost) if, and only if: [IAS 38]

- (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
- (b) the cost of the asset can be measured reliably.

This requirement applies whether an intangible asset is acquired externally or generated internally.

The probability of future economic benefits must be based on reasonable and supportable assumptions about conditions that will exist over the life of the asset. [IAS 38] The probability recognition criterion is always considered to be satisfied for intangible assets that are acquired separately or in a business combination. [IAS 38] IAS 36 '*Impairment of Assets*' also says that at each balance sheet date, an entity should review all assets to look for any indication that an asset may be impaired (its carrying amount may be in excess of the greater of its net selling price and its value in use). IAS 36 has a list of external and internal indicators of impairment. If there is an indication that an asset may be impaired, then the asset's recoverable amount should be calculated. [IAS 36] Thus the licence can be capitalised and if the exploration of the area does not lead to the discovery of oil, and activities are discontinued in the area, then an impairment test will be performed.

- 4 (a) (i) Financial instruments can be measured under IFRS in a variety of ways. For example financial assets utilise the equity method for associates, proportionate consolidation for joint ventures, fair value with gains and losses in earnings, fair value with gains and losses in other comprehensive income until realised. Financial liabilities can also utilise different measurement methods including fair value with gains and losses in earnings and amortised cost. The measurement methods used under IFRS sometimes portray an estimate of current value and others portray original cost. Some of the measurements include the effect of impairment losses, which are recognised differently under IFRS. For example financial assets at fair value through profit/loss (FVTPL) recognise changes in value in earnings, whilst those classified as 'available for sale' are measured at fair value with changes in other comprehensive income except for those impairments that are required to be reported in earnings.

The above can result in two identical instruments being measured differently by the same entity because management's intentions for realising the value of the instrument may determine the way it is measured (FVTPL compared to held to maturity investments). Management also has the option of valuing a financial instrument at fair value or at amortised cost ('available for sale' compared to 'loans and receivables'). Also the percentage of the ownership interest acquired will determine how the holding is accounted for (associate – equity method, subsidiary – acquisition method).

The different ways in which financial instruments can be measured creates problems for preparers and users of financial statements because of the following:

- (a) the criteria for deciding which instrument can be measured in a certain way are complex and difficult to apply. It is sometimes difficult to determine whether an instrument is equity or a liability and the criteria can be applied in different ways as new types of instruments are created.
 - (b) Management can choose how to account for an instrument or can be forced into a treatment that they would have preferred to avoid. For example if there is no proper documentation of the risk management or investment strategy then the FVTPL category may not be available for use and the default category of 'available for sale' may have to be utilised.
 - (c) Different gains or losses resulting from different measurement methods may be combined in the same line item in the statement of comprehensive income.
 - (d) It is not always apparent which measurement principle has been applied to which instrument and what the implications are of the difference. Comparability is affected and the interpretation of financial statements is difficult and time consuming.
- (ii)** There are several approaches that can be taken to solve the measurement and related problems. There is pressure to develop standards, which are principle-based and less complex. It has been suggested by IASB members that the long-term solution is to measure all financial instruments using a single measurement principle thus making reported information easier to understand and allowing comparisons between entities and periods. If fair value was used for all types of financial instrument then
- (a) There would be no need to 'classify' financial instruments
 - (b) There would be no requirement to report how impairment losses have been quantified
 - (c) There would be no need for rules as regards transfers between measurement categories
 - (d) There would be no measurement mismatches between financial instruments and the need for fair value hedge accounting would be reduced
 - (e) Identification and separation of embedded derivatives would not be required (this may be required for non-financial instruments)
 - (f) A single measurement method would eliminate the confusion about which method was being used for different types of financial instruments
 - (g) Entities with comparable credit ratings and obligations will report liabilities at comparable amounts even if borrowings occurred at different times at different interest rates. The reverse is true also. Different credit ratings and obligations will result in the reporting of different liabilities
 - (h) Fair value would better reflect the cash flows that would be paid if liabilities were transferred at the re-measurement date

Fair value would result in an entity reporting the same measure for security payment obligations with identical cash flow amounts and timing. At present different amounts are likely to be reported if the two obligations were incurred at different times if market interest rates change.

There is uncertainty inherent in all estimates and fair value measurements, and there is the risk that financial statements will be seen as more arbitrary with fair value because management has even more ability to affect the financial statements. Accountants need to be trained to recognise biases with respect to accounting estimates and fair value measurements so they can advise entities. It is important to demonstrate consistency in how an entity has applied the fair value principles and developed valuations to ensure credibility with investors, lenders and auditors. Although entities may select which assets and liabilities they wish to value under IAS 39, outside parties will be looking for consistency in how the standard was applied. Circumstances and market conditions change. Markets may become illiquid and the predicative models may not provide an ongoing advantage for the entity.

- (b)** Using amortised cost, both financial liabilities will result in single payments, which are almost identical at the same point in time in the future (\$59.9 million). ($\$47\text{m} \times 1.05$ for 5 years and $\$45\text{m} \times 1.074$ for 4 years) However, the carrying amounts at 30 November 2009 would be different. The initial loan would be carried at \$47 million plus interest of \$2.35 million, i.e. \$49.35 million, whilst the new loan would be carried at \$45 million even though the obligation at 30 November 2013 would be approximately the same.

If the two loans were carried at fair value, then the initial loan would be carried at \$45 million thus showing a net profit of \$2 million (interest expense of \$2.35 million and unrealised gain of \$4.35 million).

		<i>Marks</i>
1	(a) Fair value of consideration	1
	Fair value of residual interest	1
	Gain reported in comprehensive income	1
	Net assets	1
	Goodwill	2
		<hr/>
		6
	(b) Property, plant and equipment	6
	Investment property	2
	Goodwill	3
	Retained earnings	8
	Other components of equity	5
	Non-controlling interest	2
	Non-current liabilities/Trade and other payables	1
	Provisions for liabilities	3
	Intangible assets	2
	Current assets/Available for sale financial assets	1
	Investment in Associate	2
	<hr/>	
	35	
(c) Subjective up to	7	
Professional marks	2	
	<hr/>	
	50	
2		
(a) Impairment process	4	
General considerations	4	
Professional marks	2	
(b) Non-current asset at cost	6	
Non-current assets at valuation	6	
Non-currents asset held for sale	3	
	<hr/>	
	25	
3		
Revenue recognition	4	
Inventory	3	
Events after reporting period	2	
Jointly controlled	3	
Accounting for entity	2	
Decommissioning	5	
Asset definition /IAS38 /IAS 36	4	
Professional marks	2	
	<hr/>	
	25	
4		
(a) (i) 1 mark per point up to maximum	9	
(ii) 1 mark per point up to maximum	9	
Professional marks	2	
(b) Identical payment	2	
Carrying amount	1	
Fair value	2	
	<hr/>	
AVAILABLE	25	