Answers

1 (a) (i) The functional currency is a matter of fact and is the currency of the primary economic environment in which the entity operates (IAS 21). It should be determined at the entity level. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. The following factors should be considered in determining Stem's functional currency (IAS 21):

(i) the currency that mainly influences the determination of the sales prices; and
(ii) the currency of the country whose competitive forces and regulations mainly influences operating costs

The currency that dominates the determination of sales prices will normally be the currency in which the sales prices for goods and services are denominated and settled. IAS 21 requires entities to consider primary and secondary factors when determining the functional currency. These factors include the degree of autonomy and the independence of financing.

In Stem's case, sale prices are influenced by local demand and supply, and are traded in dinars. Analysis of the revenue stream points to the dinar as being the functional currency. The cost analysis is variable as the expenses are influenced by the dinar and the dollar. Additional factors to be taken into account include consideration of the autonomy of a foreign operation from the reporting entity and the level of transactions between the two. Stem operates with a considerable degree of autonomy both financially and in terms of its management. Consideration is given to whether the foreign operation generates sufficient functional cash flows to meet its cash needs, which in this case Stem does, as it does not depend on the group for finance. Therefore, the functional currency of Stem will be the dinar as the revenue is clearly influenced by the dinar, and although the expenses are mixed, secondary factors point to the fact that the functional currency is different to that of Rose.

(ii) Rose plc

Consolidated Statement of Financial Position at 30 April 2011

	$m
Assets:	
Non-current assets	
Property, plant and equipment (W6)	603·65
Goodwill (16 + 6·2) (W1 & W2)	22·2
Intangible assets (4 – 1) (W1)	3
Financial assets (W7)	32
	660·85
Current assets (118 + 100 + 66)	284
Total assets	944·85
Equity and liabilities:	
Share capital	158
Retained earnings (W3)	267·12
Exchange reserve (W3)	10·27
Other components of equity (W3)	6·98
Non-controlling interest (W5)	89·83
Total equity	532·20
Non-current liabilities (W8)	130·65
Current liabilities (W4)	282
Total liabilities	412·65
Total equity and liabilities	944·85

Working 1

Petal

	$m	$m
Fair value of consideration for 70% interest	94	
Fair value of non-controlling interest	46	140
Fair value of identifiable net assets		(120)
Total premium		20
Comprising		
Patent		4
Goodwill		16

Amortisation of patent

1 May 2010 to 30 April 2011 – $4m divided by 4 years, i.e. $1 million

Dr	Profit or loss	$1 million
Cr	Patent	$1 million

Acquisition of further interest

The net assets of Petal have increased from $124m (38 + 49 + 3 + 4 patent + 30 land (W6)) million to 131 million (98 + 3 patent + 30 land (W6)) at 30 April 2011. They have increased by $7 million and therefore the NCI has increased by 30% of $7 million, i.e. $2·1 million.

	$m
Petal NCI 1 May 2010	46
Increase in net assets	2·1
Net assets 30 April 2011	48·1
Transfer to equity 10/30	(16·03)
Balance at 30 April 2011	32·07
Fair value of consideration	19
Transfer to equity	(16·03)
Negative movement (debit) in equity	2·97

Working 2

Stem – translation and calculation of goodwill

	Dinars m	Dinars m – fair value adj	Rate	$m
Property, plant and equipment	380	75	5	91
Financial assets	50		5	10
Current assets	330		5	66
	760	75		167
Share capital	200		6	33·33
Retained earnings – pre-acquisition	220		6	36·67
– post acquisition	80		5·8	13·79
Exchange difference			Bal	18·71
Other equity		75	6	12·5
				115
Non-current liabilities	160		5	32
Current liabilities	100		5	20
	760	75		167

The fair value adjustment at acquisition is (495 – 200 – 220) million dinars, i.e. 75 million dinars.

Goodwill is measured using the full goodwill method.

	Dinars m	Rate	$m
Cost of acquisition	276	6	46
NCI	250	6	41·67
Total	526	6	87·67
Less net assets acquired	495	6	82·5
Goodwill	31	6	5·17

Goodwill is treated as a foreign currency asset, which is retranslated at the closing rate. Goodwill in the consolidated statement of financial position at 30 April 2011 will be 31 million dinars divided by 5, i.e. $6·2 million. Therefore an exchange gain of $1·03m will be recorded in retained earnings ($0·54m) and NCI ($0·49m).

Exchange difference on Stem's net assets

	$m
Net assets at 1 May 2010 $(33·33 + 36·67 + 12·5)m	82·5
Exchange difference arising on Stem's net assets	18·71
Profit for year (80m dinars/5·8)	13·79
Net assets at 30 April 2011 (575m dinars/5)	115

The exchange difference is allocated between group and NCI according to shareholding, group ($9·73m) (W3) and NCI ($8·98m) (W5).

Working 3

Tutorial note: *The exchange reserve has been shown separately. It is acceptable to have combined this with retained earnings.*

Retained earnings

	$m
Rose: balance at 30 April 2011	256
Current service cost – bonus scheme (W9)	(0·65)
Depreciation overcharged	0·4
Post acquisition reserves: Petal (70% x (56 – 49 – 1))	4·2
Stem (52% x 13·79)	7·17
	267·12

Exchange reserve

Exchange gain on goodwill (W2)	0·54
Exchange gain on net assets	9·73
Total	10·27

Other components of equity

	$m
Rose: balance at 30 April 2011	7
Post acqn reserves – Petal (70% x (4 – 3))	0·7
Petal – negative movement in equity (W1)	(2·97)
Revaluation surplus – overseas property (W6)	2·25
	6·98

Working 4

Current liabilities

	$m
Rose	185
Petal	77
Stem	20
	282

Working 5

Non-controlling interest

	$m
Petal (W1)	32·07
Stem at acquisition (W2)	41·67
Exchange gain – goodwill (W2)	0·49
Profit for year (13·79 x 48%)	6·62
Exchange gain on net assets (W2)	8·98
Total	89·83

Working 6

Property, plant and equipment

		$m	$m
Rose		370	
Petal		110	
Stem		91	
			571
Increase in value of land – Petal (120 – (38 + 49 + 3))			30
Change in residual value			
Cost $20 – residual value $1·4 = $18·6m			
New depreciable amount at 1 May 2010	$17·4m		
Less depreciation to date (18·6 x 3/6)	$9·3m		
Amount to be depreciated	$8·1m		
Depreciation over remaining three years p.a	$2·7m		
Amount charged in year (18·6 x 1/6)	$3·1m		
Depreciation overcharged			0·4
Overseas property			
cost (30m/6 dinars)	$5m		
Depreciation (5m/20)	($0·25m)		
Revalued amount (35/5)	$7m		
Revaluation surplus to equity	($7m – 4·75m)		2·25
			603·65

Working 7

Financial assets

	$m	$m
Rose	15	
Petal	7	
Stem	10	
		32

Working 8

Non-current liabilities

	$m	$m
Rose	56	
Petal	42	
Stem	32	
		130
Bonus scheme (W9)		0·65
		130·65

Working 9

Employee bonus scheme

The cumulative bonus payable will be $4·42 million.

The benefit allocated to each year will be this figure divided by five years. That is $884,000 per year. The current service cost is the present value of this amount at 30 April 2011. That is $884,000 divided by 1·08 for four years, i.e $0·65m

	30 April 2011 $m	30 April 2012 $m	30 April 2013 $m	30 April 2014 $m	30 April 2015 $m
Benefit 2% of salary which increases at 5%	0·8	0·84	0·882	0·926	0·972
Bonus cumulative	0·8	1·64	2·522	3·448	4·42

(b) Rose's allocation of the cost of acquisition of companies is not based on 'fair value' as defined in IAS 38 or IFRS 3. Further the application of fair value in accordance with IFRS may result in the identification and allocation of the cost of the business combination to other types of intangible assets in addition to those recognised by Rose.

IFRS 3 requires an acquirer to allocate the cost of a business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria at their fair values at the date of acquisition. The fair value of intangible assets that are not traded in an active market is determined at the amount that would be paid for the assets in an arm's length transaction between knowledgeable and willing parties, based on the best information available. The fair value is not an amount that is specific to the acquirer, nor should it take into account the acquirer's intentions for the future of the acquired business.

If Rose plans to allocate the cost of business combination to assets based on the value that they have for Rose, this is not in compliance with IFRS.

The contract-based customer relationships are identifiable in accordance with IAS 38 and would probably have value. In order to be recognised separately, the identifiable assets, liabilities and contingent liabilities have to satisfy the probability and reliable measurement criteria of IFRS 3. For intangible assets acquired in business combinations the probability recognition criterion is always considered to be satisfied. Furthermore, IAS 38 states that the fair value of intangible assets acquired in business combinations can normally be measured sufficiently reliably to be recognised separately from goodwill. Part of the cost of the business combination of the company should be allocated to customer relationships, assuming there to be a positive value at the date of acquisition and notwithstanding the fact that many of the customers were already known to Rose. The fair value of the customer relationships could not be based on the lack of Rose's willingness to pay but, rather, should reflect what a well-informed buyer without previous customer relationships with these customers would be willing to pay for those assets.

Management often seeks loopholes in financial reporting standards that allow them to adjust the financial statements as far as is practicable to achieve their desired aim. These adjustments amount to unethical practices when they fall outside the bounds of acceptable accounting practice. Reasons for such behaviour often include market expectations, personal realisation of a bonus, and maintenance of position within a market sector. In most cases conformance to acceptable accounting practices is a matter of personal integrity. It is often a matter of intent and therefore if the management of Rose is pursuing such policies with the intention of misleading users, then there is an ethical issue.

2 **(a)** The question arises as to whether the selling agents' estimates can be used to calculate fair value in accordance with IFRS 1 *First Time Adoption of International Financial Reporting Standards*. Assets carried at cost (e.g. property, plant and equipment) may be measured at their fair value at the date of the opening IFRS statement of financial position. Fair value becomes the 'deemed cost' going forward under the IFRS cost model. Deemed cost is an amount used as a surrogate for cost or depreciated cost at a given date. If, before the date of its first IFRS statement of financial position, the entity had revalued any of these assets under its previous GAAP either to fair value or to a price-index-adjusted cost, that previous GAAP revalued amount at the date of the revaluation can become the deemed cost of the asset under IFRS 1. It is generally advantageous to use independent estimates when determining fair value, but Lockfine should ensure that the valuation is prepared in accordance with the requirements of the relevant IFRS standard. An independent valuation should generally, as a minimum, include enough information for Lockfine to assess whether or not this is the case. The selling agents' estimates provided very little information about the valuation methods and underlying assumptions that they could not, in themselves, be relied upon for determining fair value in accordance with IAS 16 *Property, Plant and Equipment*. Furthermore it would not be prudent to value the boats at the average of the higher end of the range of values.

IFRS 1, however, does not set out detailed requirements under which fair value should be determined. Issuers who adopt fair value as deemed cost have only to provide the limited disclosures, and methods and assumptions for determining the fair value do not have to be disclosed. The revaluation has to be broadly comparable to fair value. The use of fair value as deemed cost is a cost effective alternative approach for entities which do not perform a full retrospective application of the requirements to IAS 16. Thus Lockfine was not in breach of IFRS 1 and can determine fair value on the basis of selling agent estimates.

(b) In accordance with IFRS 1, an entity which, during the transition process to IFRS, decides to retrospectively apply IFRS 3 to a certain business combination must apply that decision consistently to all business combinations occurring between the date on which it decides to adopt IFRS 3 and the date of transition. The decision to apply IFRS 3 cannot be made selectively. The entity must consider all similar transactions carried out in that period; and when allocating values to the various assets (including intangibles) and liabilities of the entity acquired in a business combination to which IFRS 3 is applied, an entity must necessarily have documentation to support its purchase price allocation. If there is no such basis, alternative or intuitive methods of price allocation cannot be used unless they are based on the strict application of the standards. The requirements of IFRS 1 apply in respect of an entity's first IFRS financial statements and cannot be extended or applied to other similar situations.

Lockfine was unable to obtain a reliable value for the fishing rights, and thus it was not possible to separate the intangible asset within goodwill. IAS 38 requires an entity to recognise an intangible asset, whether purchased or self-created (at cost) if, and only if:

– it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and
– the cost of the asset can be measured reliably.

As Lockfine was unable to satisfy the second recognition criteria of IAS 38, the company was also not able to elect to use the fair value of the fishing rights as its deemed cost as permitted by IFRS 1. As a result the goodwill presented in the first financial statements under IFRS, insofar as it did not require a write-down due to impairment at the date of transition to IFRS, will be the same as its net carrying amount at the date of transition. The intangible asset with a finite useful life, subsumed within goodwill, cannot be separately identified, amortised and presented as another item. Goodwill which includes a subsumed intangible asset with a finite life, should be subject to annual impairment testing in accordance with IAS 36 and no part of the goodwill balance should be systematically amortised through the income statement. The impairment of goodwill should be accounted for in accordance with IAS 36 which requires that there should be an annual impairment test.

(c) An intangible asset is an identifiable non-monetary asset without physical substance. Thus, the three critical attributes of an intangible asset are:

(a) identifiability
(b) control (power to obtain benefits from the asset)
(c) future economic benefits (such as revenues or reduced future costs)

The electronic maps meet the above three criteria for recognition as an intangible asset as they are identifiable, Lockfine has control over them and future revenue will flow from the maps. The maps will be recognised because there are future economic benefits attributable to the maps and the cost can be measured reliably. After initial recognition the benchmark treatment is that intangible assets should be carried at cost less any amortisation and impairment losses and thus Lockfine's accounting policy is in compliance with IAS 38.

An intangible asset has an indefinite useful life when there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. The term indefinite does not mean infinite. An important underlying assumption in assessing the useful life of an intangible asset is that it reflects only the level of future maintenance expenditure required to maintain the asset 'at its standard of performance assessed at the time of estimating the asset's useful life'. The indefinite useful life should not depend on planned future expenditure in excess of that required to maintain the asset. The company's accounting practice in this regard seems to be in compliance with IAS 38. IAS 38 identifies certain factors that may affect the useful life and it is important that Lockfine complies with IAS 38 in this regard. For example, technical, technological or commercial obsolescence and expected actions by competitors. IAS 38 specifies the criteria that an entity must be able to satisfy in order to recognise an intangible asset arising from development. There is no specific requirement that this be disclosed. However, IAS 1 *Presentation of Financial Statements* requires that an entity discloses accounting policies relevant to an understanding of its financial statements. Given that the internally generated intangible assets are a material amount of total assets, this information should also have been disclosed.

(d) The restructuring plans should be considered separately as they relate to separate and different events.

According to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, a constructive obligation to restructure arises only when an entity:

(a) Has a detailed formal restructuring plan identifying at least:

  (i) the business activities, or part of the business activities, concerned;
  (ii) the principal locations affected;
  (iii) the location, function and approximate number of employees who will be compensated for terminating their services;
  (iv) the expenditure that will be undertaken;
  (v) the implementation date of the plan; and, in addition,

(b) Has raised a valid expectation among the affected parties that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely (IAS 37).

In the case of Plan A, even though Lockfine has made a decision to sell 50% of the operation and has announced that decision publicly, Lockfine is not committed to the restructure until both (a) and (b) above have been satisfied. A provision for restructuring should not be recognised. A constructive obligation arises only when a company has a detailed formal plan and makes an announcement of the plan to those affected by it. The plan to date does not provide sufficient detail that would permit Lockfine to recognise a constructive obligation. Neither the specific fleet nor employees have been identified as yet.

In the case of Plan B, Lockfine should recognise a provision. At the date of the financial statements, there has to be a detailed plan and the company has to have raised a valid expectation in those affected by starting to implement that plan or announcing its main features to those affected by it. A public announcement constitutes a constructive obligation to restructure only if it is made in such a way and in such detail that it gives rise to a valid expectation. It is not necessary that the individual employees of Lockfine be notified as the employee representatives have been notified. It will be necessary to look at the nature of the negotiations and if the discussions are about the terms of the redundancy and not a change in plans, then a provision should be made.

3 **(a)** The loan should have been classified as short-term debt. According to IAS 1, *Presentation of financial statements*, a liability should be classified as current if it is due to be settled within 12 months after the date of the statement of financial position. If an issuer breaches an undertaking under a long-term loan agreement on or before the date of the statement of financial position, such that the debt becomes payable on demand, the loan is classified as current even if the lender agrees, after the statement of financial position date, not to demand payment as a consequence of the breach. It follows that a liability should also be classified as current if a waiver is issued before the date of the statement of financial position, but does not give the entity a period of grace ending at least 12 months after the date of the statement of financial position. The default on the interest payment in November represented a default that could have led to a claim from the bondholders to repay the whole of the loan immediately, inclusive of incurred interest and expenses. As a further waiver was issued after the date of the statement of financial position, and only postponed payment for a short period, Alexandra did not have an unconditional right to defer the payment for at least 12 months after the date of the statement of financial position as required by the standard in order to be classified as long-term debt. Alexandra should also consider the impact that a recall of the borrowing would have on the going concern status. If the going concern status is questionable then Alexandra would need to provide additional disclosure surrounding the uncertainty and the possible outcomes if waivers are not renewed. If Alexandra ceases to be a going concern then the financial statements would need to be prepared on a break-up basis.

(b) The change in accounting treatment should have been presented as a correction of an error in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, as the previous policy applied was not in accordance with IAS 18, *Revenue*, which requires revenue arising from transactions involving the rendering of services to be recognised with reference to the stage of completion at the date of the statement of financial position. The change in accounting treatment should not be accounted for as a change in estimate. According to IAS 8 changes in an accounting estimate result from changes in circumstances, new information or more experience, which was not the case. Alexandra presented the change as a change in accounting estimate as, in its view, its previous policy complied with the standard and did not breach any of its requirements. However, IAS 18 paragraph 20, requires that revenue associated with the rendering of a service should be recognised by reference to the stage of completion of the transaction at the end of the reporting period, providing that the outcome of the transaction can be estimated reliably. IAS 18 further states that, when the outcome cannot be estimated reliably, revenue should be recognised only to the extent that expenses are recoverable. Given that the maintenance contract with the customer involved the rendering of services over a two-year period, the previous policy applied of recognising revenue on invoice at the commencement of the contract did not comply with IAS 18. The subsequent change in policy to one which recognised revenue over the contract term, therefore, was the correction of an error rather than a change in estimate and should have been presented as such in accordance with IAS 8 and been effected retrospectively. In the opening balance of retained earnings, the income from maintenance contracts that has been recognised in full in the year ended 30 April 2010, needs to be split between that occurring in the year and that to be recognised in future periods. This will result in a net debit to opening retained earnings as less income will be recognised in the prior year. Comparative figures for the income statement require restatement accordingly.

In the current year, the maintenance contracts have already been dealt with following the correct accounting policy. The income from the maintenance contracts deferred from the revised opening balance will be recognised in the current year as far as they relate to that period. As the maintenance contracts only run for two years, it is likely that most of the income deferred from the prior year will be recognised in the current period. The outcome of this is that there will be less of an impact on the income statement as although this year's profits have reduced by $6m, there will be an addition of profits resulting from the recognition of maintenance income deferred from last year.

(c) The exclusion of the remuneration of the non-executive directors from key management personnel disclosures did not comply with the requirements of IAS 24 which defines key management personnel as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Alexandra did not comply with paragraph 16 of the standard, which also requires key management personnel remuneration to be analysed by category. The explanation of Alexandra is not acceptable. IAS 24 states that an entity should disclose key management personnel compensation in total and for each of the following categories:

(a) short-term employee benefits;
(b) post-employment benefits;
(c) other long-term benefits;
(d) termination benefits; and
(e) share-based payment.

Providing such disclosure will not give information on what individual board members earn as only totals for each category need be disclosed, hence will not breach any cultural protocol. However legislation from local government and almost certainly local corporate governance will require greater disclosure for public entities such as Alexandra.

By not providing an analysis of the total remuneration into the categories prescribed by the standard, the disclosure of key management personnel did not comply with the requirements of IAS 24.

(d) Alexandra's pension arrangement does not meet the criteria as outlined in IAS 19 *Employee Benefits* for defined contribution accounting on the grounds that the risks, although potentially limited, remained with Alexandra.

Alexandra has to provide for an average pay pension plan with limited indexation, the indexation being limited to the amount available in the trust fund. The pension plan qualifies as a defined benefit plan under IAS 19.

The following should be taken into account:

The insurance contract is between Alexandra and the insurance company, not between the employee and the insurer; the insurance contract is renewed every year. The insurance company determines the insurance premium payable by Alexandra annually.

The premium for the employee is fixed and the balance of the required premium rests with Alexandra, exposing the entity to changes in premiums depending on the return on the investments by the insurer and changes in actuarial assumptions. The insurance contract states that when an employee leaves Alexandra and transfers his pension to another fund, Alexandra is liable for or is refunded the difference between the benefits the employee is entitled to based on the pension formula and the entitlement based on the insurance premiums paid. Alexandra is exposed to actuarial risks, i.e. a shortfall or over funding as a consequence of differences between returns compared to assumptions or other actuarial differences.

There are the following risks associated with the pension plan:

– Investment risk: the insurance company insures against this risk for Alexandra. The insurance premium is determined every year, the insurance company can transfer part of this risk to Alexandra to cover shortfalls. Therefore, the risk is not wholly transferred to the insurance company.

– Individual transfer of funds: on transfer of funds, any surplus is refunded to Alexandra while unfunded amounts have to be paid; a risk that can preclude defined contribution accounting.

– The agreement between Alexandra and the employees does not include any indication that, in the case of a shortfall in the funding of the plan, the entitlement of the employees may be reduced. Consequently, Alexandra has a legal or constructive obligation to pay further amounts if the insurer did not pay all future employee benefits relating to employee service in the current and prior periods. Therefore the plan is a defined benefit plan.

4 (a) (i) IFRS 9 *Financial instruments* retains a mixed measurement model with some assets measured at amortised cost and others at fair value. The distinction between the two models is based on the business model of each entity and a requirement to assess whether the cash flows of the instrument are only principal and interest. The business model approach is fundamental to the standard and is an attempt to align the accounting with the way in which management uses its assets in its business whilst also looking at the characteristics of the business. A debt instrument generally must be measured at amortised cost if both the 'business model test' and the 'contractual cash flow characteristics test' are satisfied. The business model test is whether the objective of the entity's business model is to hold the financial asset to collect the contractual cash flows rather than have the objective to sell the instrument prior to its contractual maturity to realise its fair value changes.

The contractual cash flow characteristics test is whether the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All recognised financial assets that are currently in the scope of IAS 39 will be measured at either amortised cost or fair value. The standard contains only the two primary measurement categories for financial assets unlike IAS 39 where there were multiple measurement categories. Thus the existing IAS 39 categories of held to maturity, loans and receivables and available-for-sale are eliminated along with the tainting provisions of the standard.

A debt instrument (e.g. loan receivable) that is held within a business model whose objective is to collect the contractual cash flows and has contractual cash flows that are solely payments of principal and interest generally must be measured at amortised cost. All other debt instruments must be measured at fair value through profit or loss (FVTPL). An investment in a convertible loan note would not qualify for measurement at amortised cost because of the inclusion of the conversion option, which is not deemed to represent payments of principal and interest. This criterion will permit amortised cost measurement when the cash flows on a loan are entirely fixed such as a fixed interest rate loan or where interest is floating or a combination of fixed and floating interest rates.

IFRS 9 contains an option to classify financial assets that meet the amortised cost criteria as at FVTPL if doing so eliminates or reduces an accounting mismatch. An example of this may be where an entity holds a fixed rate loan receivable that it hedges with an interest rate swap that swaps the fixed rates for floating rates. Measuring the loan asset at amortised cost would create a measurement mismatch, as the interest rate swap would be held at FVTPL. In this case the loan receivable could be designated at FVTPL under the fair value option to reduce the accounting mismatch that arises from measuring the loan at amortised cost.

All equity investments within the scope of IFRS 9 are to be measured in the statement of financial position at fair value with the default recognition of gains and losses in profit or loss. Only if the equity investment is not held for trading can an irrevocable election be made at initial recognition to measure it at fair value through other comprehensive income (FVTOCI) with only dividend income recognised in profit or loss. The amounts recognised in OCI are not recycled to profit or loss on disposal of the investment although they may be reclassified in equity.

The standard eliminates the exemption allowing some unquoted equity instruments and related derivative assets to be measured at cost. However, it includes guidance on the rare circumstances where the cost of such an instrument may be appropriate estimate of fair value.

The classification of an instrument is determined on initial recognition and reclassifications are only permitted on the change of an entity's business model and are expected to occur only infrequently. An example of where reclassification from amortised cost to fair value might be required would be when an entity decides to close its mortgage business, no longer accepting new business, and is actively marketing its mortgage portfolio for sale. When a reclassification is required it is applied from the first day of the first reporting period following the change in business model.

All derivatives within the scope of IFRS 9 are required to be measured at fair value. IFRS 9 does not retain IAS 39's approach to accounting for embedded derivatives. Consequently, embedded derivatives that would have been separately accounted for at FVTPL under IAS 39 because they were not closely related to the financial asset host will no longer be separated. Instead, the contractual cash flows of the financial asset are assessed as a whole and are measured at FVTPL if any of its cash flows do not represent payments of principal and interest.

One of the most significant changes will be the ability to measure some debt instruments, for example investments in government and corporate bonds at amortised cost. Many available-for-sale debt instruments currently measured at fair value will qualify for amortised cost accounting.

Many loans and receivables and held-to-maturity investments will continue to be measured at amortised cost but some will have to be measured instead at FVTPL. For example some instruments, such as cash-collateralised debt obligations, that may under IAS 39 have been measured entirely at amortised cost or as available-for-sale will more likely be measured at FVTPL. Some financial assets that are currently disaggregated into host financial assets that are not at FVTPL will instead by measured at FVTPL in their entirety.

IFRS 9 may result in more financial assets being measured at fair value. It will depend on the circumstances of each entity in terms of the way it manages the instruments it holds, the nature of those instruments and the classification elections it makes.

Assets that are currently classified as held-to-maturity are likely to continue to be measured at amortised cost as they are held to collect the contractual cash flows and often give rise to only payments of principal and interest.

IFRS 9 does not directly address impairment. However, as IFRS 9 eliminates the available-for-sale (AFS) category, it also eliminates the AFS impairment rules. Under IAS 39 measuring impairment losses on debt securities in illiquid markets based on fair value often led to reporting an impairment loss that exceeded the credit loss that management expected. Additionally, impairment losses on AFS equity investments cannot be reversed within the income statement section of the statement of comprehensive income under IAS 39 if the fair value of the investment increases. Under IFRS 9, debt securities that qualify for the amortised cost model are measured under that model and declines in equity investments measured at FVTPL are recognised in profit or loss and reversed through profit or loss if the fair value increases.

(ii) Under the general rules of retrospective application of IAS 8, the financial statements for the year ended 30 April 2011 would have an opening adjustment to equity of $1,500 credit as at 1 May 2010 ($106,500 minus $105,000). The fair value of the asset was $106,500 on 30 April 2010 and $111,000 on 30 April 2011 and therefore $4,500 will be credited to profit or loss for the year ended 30 April 2011.

(b) (i) The expected loss model is more subjective in nature compared to the incurred loss model, since it relies significantly on the cash flow estimates prepared by the reporting entity which are inherently subjective. Therefore safeguards are needed to be built into the process such as disclosures of methods applied. The expected loss model would involve significant operational challenges notably it is onerous in data collection since data needs to be collected for the whole portfolio of financial assets measured at amortised cost held by a reporting entity. This means that data is not only required for impaired financial assets but it also requires having historical loss data for all financial assets held at amortised cost. Entities do not always have historical loss data for financial assets, particularly for some types of financial asset or some types of markets. The historical loss data often does not reflect the losses to maturity or the historical data are not relevant due to significant changes in circumstances.

(ii) Incurred loss model per IAS 39

Date	Loan asset (A) $000	Interest at 16% (B) $000	Cash flow $000	Loss (C) $000	Loan asset $000	Return (B – C)/A%
y/e 30 April 11	5,000	800	(800)	0	5,000	16%
y/e 30 April 12	5,000	800	(800)	0	5,000	16%
y/e 30 April 13	5,000	800	(728)	522	4,550	5·56%
			being 800 x 91%			

Expected loss model

Date	Loan asset (A) $000	Interest at 9·07% (B) $000	Cash flow $000	Loan asset $000	Return B/A%
y/e 30 April 11	5,000	453·5	(800)	4,653·5	9·07%
y/e 30 April 12	4,653·5	422·1	(800)	4,275·6	9·07%
y/e 30 April 13	4,275·6	387·8	(728)	3,935·4	9·07%
			being 800 x 91%		

The expected loss model matches the credit loss on the same basis as interest revenue recognised from the financial asset. Under an expected loss model revenue is set aside to cover expected future credit losses. The expected loss model has the effect of smoothing the reported income for cash flows that are not expected to accrue evenly over the life of the portfolio as impairment is recognised earlier. The IAS 39 model is based on the perspective of matching a credit loss to the period in which that loss was incurred. This results in loan loss expenses being recognised later in the life of the instrument. Interest income is recognised in full without considering expected credit losses until they have actually been incurred. This model is therefore characterised by higher revenues due to the period immediately after initial recognition, followed by lower net income if credit losses are incurred.

				Marks
1	**(a)**	**(i)**	1 mark per point up to maximum	7
		(ii)	Amortisation of patent	1
			Acquisition of further interest	5
			Stem – translation and calculation of goodwill	7
			Retained earnings and other equity	8
			Non-controlling interest	3
			Property, plant and equipment	6
			Non-current liabilities	1
			Employee bonus scheme	4
				35
	(b)	Accounting treatment		4
		Ethical considerations		2
		Professional marks		2
				50
2	**(a)**	1 mark per point maximum		6
	(b)	1 mark per point maximum		6
	(c)	1 mark per point maximum		6
	(d)	1 mark per point maximum		5
	Professional marks			2
				25
3	**(a)**	1 mark per point up to maximum		6
	(b)	1 mark per point up to maximum		5
	(c)	1 mark per point up to maximum		5
	(d)	1 mark per point up to maximum		7
	Professional marks			2
				25
4	**(a)**	**(i)**	1 mark per point maximum	11
		(ii)	IAS 8	1
			$1,500 credit to equity	1
			$4,500 will be credited to profit or loss	2
				4
	(b)	**(i)**	1 mark per point up to	4
		(ii)	Calculations	4
		Professional marks		2
				25