Answers

1 Minny Group

(a) Consolidated Statement of Financial Position at 30 November 2012

	$m
Assets:	
Non-current assets:	
Property, plant and equipment (W9)	1,606·00
Goodwill (W2)	190·00
Intangible assets (W8)	227·00
Investment in Puttin (W3)	50·50
	2,073·50
Current assets (W10)	1,607·00
Disposal group (W11)	33·00
Total assets	3,713·50
Equity and liabilities	
Equity attributable to owners of parent	
Share capital	920·00
Retained earnings (W5)	936·08
Other components of equity (W5)	77·80
	1,933·88
Non-controlling interest (W7)	394·62
	2,328·50
Total non-current liabilities (W10)	711·00
Disposal group (W11)	3·00
Current liabilities (W6)	671·00
Total liabilities	1,385·00
Total equity and liabilities	3,713·50

Working 1

Bower

	$m	$m
Purchase consideration		730
Fair value of non-controlling interest		295
Fair value of identifiable net assets acquired:		
Share capital	400	
Retained earnings	319	
OCE	27	
FV adjustment – land	89	
		(835)
Goodwill		190

Working 2

Heeny

	$m	$m
Purchase consideration –		320
Less consideration belonging to NCI – (30% of $320)		(96)
NCI fair value of 44% holding		161
Fair value of identifiable net assets:		
Share capital	200	
Retained earnings	106	
OCE	20	
FV adjustment – land	36	
		(362)
Goodwill		23

Impairment test of Bower and Heeny

	Bower $m	Heeny $m
Goodwill	190	23
Assets	1,130	595
Fair value adjustment	89	36
Total asset value	1,409	654
Recoverable amount	(1,425)	(604)
Impairment	n/a	50

There is no impairment in the case of Bower but Heeny's assets are impaired. Goodwill of $23 million plus $27 million of the intangible assets will be written off. The reason for the latter write down is because the directors feel that the reason for the reduction in the recoverable amount is due to the intangible assets' poor performance.

Group reserves will be debited with $28 million and NCI with $22 million, being the loss in value of the assets split according to the profit sharing ratio.

Total goodwill is therefore ($190m + $23m – $23m impairment), i.e. <u>$190 million</u>

Working 3

Puttin

The gain of $3 million ($21m – $18m) recorded within OCE up to 1 June 2012 would not be transferred to profit or loss for the year but can be transferred within equity and hence to retained earnings under IFRS 9 *Financial Instruments*.

The amount included in the consolidated statement of financial position would be:

	$m
Cost ($21 million + $27 million)	48
Share of post-acquisition profits ($30 million x 0·5 x 30%)	4·5
Less dividend received	(2·0)
	50·5

The dividend should have been credited to Minny's profit or loss and not OCI. Dividend income as an investment and as an associate is treated in the same way as a credit to profit or loss. There is no impairment as the carrying amount of the investment in the separate financial statements does not exceed the carrying amount in the consolidated financial statements nor does the dividend exceed the total comprehensive income of the associate in the period in which the dividend is declared.

Working 4

Intangible assets

Minny should recognise the $10 million as an intangible asset plus the cost of the prototype of $4 million and the $3 million to get it into condition for sale. The remainder of the costs should be expensed including the marketing costs. This totals $9 million, which should be taken out of intangibles and expensed.

Dr Retained earnings $9 million
Cr Intangible assets $9 million

Working 5

Retained earnings

		$m
Balance at 30 November 2012: Minny		895·00
Post-acquisition reserves:	Bower (70% of (442 – 319))	86·10
	Heeny (56% of (139 – 106))	18·48
Puttin: fair value of investment at acquisition from OCE		3·00
Puttin: share of post-acquisition retained profits (W3) (4·5 – 2)		2·50
Dividend income from OCE		2·00
Intangible assets		(9·00)
Impairment loss on goodwill of Heeny (W2)		(28·00)
Impairment loss on disposal group (W11)		(34·00)
Total		936·08

Other components of equity

	$m
Balance at 30 November 2012: Minny	73
Post-acquisition reserves: Bower (70% of (37 – 27))	7
Heeny (56% of (25 – 20))	2·8
Dividend income to retained earnings	(2)
Transfer to retained earnings	(3)
	77·8

Working 6

Current liabilities

	$m
Balance at 30 November 2012	
Minny	408
Bower	128
Heeny	138
	674
Disposal group	(3)
	671

Working 7

Non-controlling interest

	$m
Bower (W1)	295
Heeny (W2) – purchase consideration	(96)
Fair value	161
Post-acquisition reserves – Bower	
Retained earnings (30% of (442 – 319))	36·9
OCE (30% of (37 – 27))	3
Heeny	
Retained earnings (44% of (139 – 106))	14·52
OCE (44% of (25 – 20))	2·2
Impairment loss (W2)	(22)
	394·62

Working 8

Intangibles

	$m	$m
Minny	198	
Bower	30	
Heeny	35	
Intangible expensed	(9)	
Impairment of intangible	(27)	
		227

Working 9

Property, plant and equipment

	$m	$m
Minny	920	
Bower	300	
Heeny	310	
		1,530
Increase in value of land – Bower (W1)		89
Increase in value of land – Heeny (W2)		36
		1,655
Disposal group		(49)
		1,606

Working 10

Non-current liabilities

	$m	$m
Minny	495	
Bower	123	
Heeny	93	
		711

Current assets

	$m	$m
Minny	895	
Bower	480	
Heeny	250	
		1,625
Disposal group		(18)
		1,607

Working 11

Disposal group

	$m
PPE	49
Inventory	18
Current liabilities	(3)
Proceeds	(30)
Impairment loss	34

The assets and liabilities will be shown as single line items in the statement of financial position. Assets at ($67 – 34 m), i.e. $33 million and liabilities at $3 million. A plan to dispose of net assets is an impairment indicator.

(b) An asset or disposal group is available for immediate sale in its present condition, if the entity has the intention and ability to transfer the asset or disposal group to a buyer. There is no guidance in the standard on what constitutes available for immediate sale but the guidance notes set out various examples. Customary terms of sale such as surveys and searches of property do not preclude the classification as held for sale. However, present conditions do not include any conditions that have been imposed by the seller of the asset or disposal group, such as if planning permission is required before sale. In this case, the asset is not held for sale. The problem is determining whether the entity truly intends to dispose of the group of assets.

A sale is 'highly probable' where it is significantly more likely than probable that the sale will occur and probable is defined as 'more likely than not'. IFRS 5 attempts to clarify what this means by setting out the criteria for a sale to be highly probable. These criteria are: there is evidence of management commitment; there is an active programme to locate a buyer and complete the plan; the asset is actively marketed for sale at a reasonable price compared to its fair value; the sale is expected to be completed within 12 months of the date of classification; and actions required to complete the plan indicate that it is unlikely that there will be significant changes to the plan or that it will be withdrawn.

Because the standard defines 'highly probable' as 'significantly more likely than probable', this creates a high threshold of certainty before recognition as held-for-sale. IFRS 5 expands on this requirement with some specific conditions but the uncertainty still remains. Thus, a number of issues has arisen over the implementation of the standard, mainly due to the fact that there is subjectivity over the requirements of the standard.

(c) A company may distribute non-cash assets. The transfer of the asset from Bower to Minny amounts to a distribution of profits rather than a loss on disposal. The shortfall between the sale proceeds and the carrying amount is $1 million and this will be treated as a distribution. Bower has retained earnings of $442 million available at the year end plus the sale of the non-current asset will 'realise' an additional amount of $400,000 from the revaluation reserve. It is likely that the sale will be legal, depending upon the jurisdiction concerned. If the transaction meets the criteria of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* paragraphs 6 to 8, then the asset would be held in the financial statements of Bower in a separate category from plant, property and equipment and would be measured at the lower of carrying amount at held-for-sale date and fair value less costs to sell. If the asset is held for sale, IAS 16 *Property, Plant and Equipment* does not apply.

The boundary between ethical practices and legality is sometimes blurred. Questions would be asked of the directors as to why they would want to sell an asset at half of its current value, assuming that $2 million is the current value and that $1 million is not a fair approximation of fair value. It may raise suspicion. Corporate reporting involves the development and disclosure of information, which should be truthful and neutral. Both Bower and Minny would need to make related party disclosures so that the transaction is understood by stakeholders.

The nature of the responsibility of the directors requires a high level of ethical behaviour. Shareholders, potential shareholders, and other users of the financial statements rely heavily on the financial statements of a company as they can use this information to make an informed decision about investment. They rely on the directors to present a true and fair view of the company. Unethical behaviour is difficult to control or define. However, it is likely that this action will cause a degree of mistrust between the directors and shareholders unless there is a logical business reason for their actions. Shareholders in most jurisdictions who receive an unlawful dividend are liable to repay it to the company.

2 (a) Coate should determine, apply and disclose appropriate policies covering the acquisition, the presentation and measurement of the certificates in its financial statements. The green certificates should be accounted for as government grants in accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. The green certificates qualify as government grants in accordance with IAS 20, as they represent assistance by government in the form of resources provided to an entity in return for past compliance with certain conditions relating to its operating activities. A government grant is recognised only when there is reasonable assurance that the entity will comply with any conditions attached to the grant and the grant will be received.

A grant is recognised as income over the period necessary to match it with the related costs, for which they are intended to compensate, on a systematic basis.

The certificates are income-related grants according to the standard as the certificates are not long-term assets. The qualification of the green certificates as income-related grants has implications for the financial statements. In accordance with IAS 20, the green certificates must be shown as a credit in profit or loss, either separately or under a general heading such as 'Other income'. Alternatively, they must be deducted in reporting the related expense. Additionally, Coate should disclose an accounting policy for government grants and provide the additional disclosures required in respect of the nature and extent of the government assistance given and any unfulfilled conditions or other contingencies attaching.

To the extent that the certificates were not sold by the end of the accounting period, Coate should recognise them under inventories in accordance with IAS 2 *Inventories*, as they are held for sale in the ordinary course of business within the meaning of the standard. On sale, the income from green certificates is shown as 'Sale of green certificates' in accordance with IAS 18 *Revenue* and the related green certificates, included in inventory, are charged to production as part of the cost of sales.

The journal entry to record the quarterly receipt of the grant is:

DR	Certificate (SOFP)	$fair value of certificate at receipt
CR	Deferred revenue (SOFP)	$fair value of certificate at receipt

On the sale of a certificate – this is when its value is realised and the following entries will be posted:

DR	Deferred revenue (SOFP)	$fair value of certificate at receipt
CR	Cost of sale (SOCI)	$fair value of certificate at receipt

Being a contribution to the cost of generating electricity.

DR	Bank/Receivable (SOFP)	$fair value of trade
CR	Certificate (SOFP)	$fair value of certificate at receipt
DR/CR	Revenue (SOCI)	$balance

Being the surplus or deficit as compared to the proceeds received from the national government and hence the true value of the sale of the certificate.

The accounting policies relating to the accounting treatment of the green certificates should be disclosed in the financial statements as required by IAS 1 *Presentation of Financial Statements*.

(b) IAS 7 *Statement of Cash Flows* states that unrealised gains and losses arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences had those cash flows been reported at the end of period exchange rates.

The method of translation for foreign operations in IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires monetary and non-monetary assets and liabilities to be translated at the closing rate, and income and expense items to be translated at the rate ruling at the date of the transaction or an average rate that approximates to the actual exchange rates. All exchange differences are taken to a separate component of equity, until disposal of the foreign operation when they are classified from equity to profit or loss.

All exchange differences relating to the retranslation of a foreign operation's opening net assets to the closing rate will have been recognised in other comprehensive income and presented in a separate component of equity. As such exchange differences have no cash flow effect, they will not be included in the consolidated statement of cash flows. However, the opening net assets of Coate include foreign currency cash and cash equivalents; therefore the exchange difference arising on their retranslation at the closing rate for the current period will have been reflected in the closing balances in the financial statements. Such translation differences should be reported in the cash flow statement to determine the total movement in cash and cash equivalents in the period.

(c) In accordance with IFRS 10 *Consolidated Financial Statements*, an investor considers all relevant facts and circumstances when assessing whether it controls an investee. An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

An investor controls an investee if and only if the investor has all of the following elements:

– power over the investee, that is the investor has existing rights that give it the ability to direct the relevant activities (the activities that significantly affect the investee's returns)
– exposure, or rights, to variable returns from its involvement with the investee
– the ability to use its power over the investee to affect the amount of the investor's returns.

Power arises from rights which may be obvious through voting rights or be complex because of contractual arrangements. An investor that holds only protective rights cannot have power over an investee and so cannot control an investee. A parent must also have the ability to use its power over the investee to affect its returns from its involvement with the investee.

The shareholder agreement shows that Coate has influence over the company but the restrictions in the agreement with regards to decisions to be made in the ordinary course of business, such as consensus between shareholders required for acquisition of assets above a certain value, employment or dismissal of senior employees, distribution of dividends or establishment of loan facilities, indicates that Coate does not control Patten. Such terms of the agreement indicate the existence of a joint arrangement in accordance with IFRS 11 *Joint Arrangements*, that is a joint venture, as decisions are made at entity level operations and not regarding individual assets and liabilities.

Coate argued that the restrictions do not constitute a hindrance to the power to control, as it is customary within the industry to require shareholder consensus for decisions of the types listed in the shareholders' agreement.

However, the agreement contains so many significant restrictions with respect to operating and financial decisions that it does not entail control of Patten. As shareholder consensus is required in respect of many significant decisions, Coate is unable to utilise the position it has at board level where it has the power to cast the majority of votes.

As such, Coate is required to deconsolidate Patten as a subsidiary from its group accounts as it does not control the entity. Further, Coate should account for Patten in accordance with IAS 28 *Associates and Joint Ventures*. This will require Coate to equity account for Patten within the consolidated financial statements.

(d) The tax adjustments resulting from the taxation authority audits should be treated as a change in an accounting estimate and not as a prior period adjustment. Tax expenses are difficult to estimate correctly and tax computations are open for review or audit by taxation authorities for a number of years after the end of the reporting period. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides that the effect of a change in an accounting estimate should be recognised prospectively by including it in profit or loss in the period of the change. It also states that an entity should correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by restating the comparative amounts. A prior period error is an omission from or misstatement in the entity's financial statements arising from a failure to use or misuse of reliable information that was available at the time of authorisation of the financial statements and could reasonably be expected to have been obtained and taken into account at the time of their preparation and presentation.

IAS 12 *Income Taxes* requires separate disclosure of the major components of the tax expense. It states that such components may include any adjustments recognised in the period for current tax of prior periods and the deferred tax expense. Thus, separate disclosure of these elements of the tax adjustments is required. The audit adjustments did not arise from a failure to use reliable information, which was available during previous reporting periods, as Coate correctly applied the provisions of tax law. The issues that the adjustments related to were transfer pricing issues for which there was a range of possible outcomes that were negotiated during 2012 with the taxation authorities. This indicates that these adjustments were effectively a change in an accounting estimate. Further at 30 November 2011, Coate had accounted for all known issues arising from the audits to that date and the adjustment could not have been foreseen as at 30 November 2011, as the audit authorities changed the scope of the audit. Thus, the adjustments could not have been made at 30 November 2011 as the information and conditions did not exist at that date. Further, no penalties were expected to be applied by the taxation authorities, which indicates that there were no errors in the provision of information to the authorities, which again points to a change in accounting estimate and not a prior period error.

3 **(a)** IAS 40 *Investment Property* sets out the accounting treatment for investment property and the related disclosure requirements. It deals with the recognition, measurement and disclosure of investment property. The scope includes property held for capital appreciation or to earn rentals. Investment property is defined as property held by the owner or held on a finance lease to earn rentals or for capital appreciation or both, rather than for:

– use in producing or supplying goods or services or for administrative purposes; or
– sale in the ordinary course of business.

The definition excludes owner-occupied property, property intended for sale in the ordinary course of business, property being constructed on behalf of third parties and property that is leased to a third party under a finance lease.

Where the fair value model under IAS 40 is applied, such a property is measured at fair value. Where an entity provides ancillary services to occupants of a property owned by the entity, the property is an investment property if such ancillary services are a relatively insignificant portion of the arrangement as a whole. Where, however, such services are a more significant portion, such as in a hotel, the property is treated not as investment property, but as an owner-occupied property.

Investment property should be recognised as an asset when it is probable that the future economic benefits associated with the property will flow to the entity and the cost of the property can be reliably measured.

Thus, the land that is owned by Blackcutt for capital appreciation which may be sold at any time in the future and the land that has no current purpose are both considered to be investment property under IAS 40. If the land has no current purpose, it is considered to be held for capital appreciation.

Blackcutt supplements its income by buying and selling property, and the housing department regularly sells part of its housing inventory. As these sales are in the ordinary course of its operations and are routinely occurring, then the housing stock held for sale will be classified as inventory. The part of the inventory held to provide housing to low-income employees at below market rental will not be treated as investment property as the property is not held for capital appreciation and the income just covers the cost of maintaining the properties and thus is not for profit. The property is held to provide housing services rather than rentals. The rental revenue is incidental to the purposes for which the property is held. This property will be accounted for under IAS 16 *Property, Plant and Equipment*. The property is treated as owner occupied as set out above.

(b) An entity may enter into an arrangement that does not take the legal form of a lease but conveys a right to use an asset. An entity should use the Conceptual Framework for Financial Reporting in conjunction with IAS 17 *Leases* to determine whether such arrangements are, or contain, leases that should be accounted for in accordance with the standard. Determining whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of:

(i) the risks and rewards of the arrangement and how best to recognise them;
(ii) the right to use the asset or direct others to use the asset;
(iii) the right to control the use of the underlying asset by operating the asset or directing others to operate the asset;
(iv) who obtains much of the benefit from the asset.

In this case, the private sector provider purchases the vehicles and uses them exclusively for the local government organisation. The vehicles are ostensibly those of Blackcutt as they are painted with the local government name and colours. Blackcutt can use the vehicles and the vehicles are used in this connection for nearly all of the asset's life. In the event of the private sector provider's business ceasing, Blackcutt can obtain legal title to the vehicles and carry on the refuse collection service. Thus, the arrangement fits the terms of a lease and Blackcutt should account for the vehicles as a finance lease.

The value associated with the lease can be obtained by considering the fair value of acquiring the vehicle. This will also be the initial lease obligation. The payment made by Blackcutt to the leasing company may be two-fold, representing the cost of the lease obligation and the service element relating to the cost of the collection of the waste.

(c) A provision shall be recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* when there is a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the above conditions are not met, no provision shall be recognised. In this case, the obligating event is the contamination of the land because of the virtual certainty of legislation requiring the clean up. Additionally, there is probably going to be an outflow of resources embodying economic benefits, because Blackcutt has no recourse against the entity or its insurance company. Therefore a provision is recognised for the best estimate of the costs of the clean up. As Blackcutt has no recourse against Chemco, recovery of the costs of clean up is not likely and hence no corresponding receivable should be recorded.

(d) An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and IAS 36 *Impairment of Assets* requires the recognition of an impairment loss. At the end of each reporting period, an assessment should take place as to whether there is any indication that an asset may be impaired. If any indication exists, the recoverable amount should be estimated taking into account the concept of materiality in identifying whether the recoverable amount of an asset needs to be estimated. If no indication of an impairment loss is present, IAS 36 does not require a formal estimate of the recoverable amount, with the exception of intangible assets.

Impairment in this case is indicated because the purpose for which the building is used has changed significantly from a place for educating students to a library and this is not anticipated to change for the foreseeable future. There is insufficient information to determine value in use and net selling price (fair value less selling costs); as such, depreciated replacement cost should be used as an approximation of the recoverable amount. An impairment loss using a depreciated replacement cost approach would be determined as follows:

Asset	**Cost/replacement cost $000**	**Accumulated depreciation $000 – 6/25**	**Carrying amount/ replacement cost $000 30 November 2012**
School	5,000	(1,200)	3,800
Library	2,100	(504)	(1,596)
Impairment loss			2,204

Thus Blackcutt would record the impairment loss of $2·204m.

4 **(a)** **(i)** Fair value has had a different meaning depending on the context and usage. The IASB's definition is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Basically it is an exit price. Fair value is focused on the assumptions of the market place and is not entity specific. It therefore takes into account any assumptions about risk. Fair value is measured using the same assumptions and taking into account the same characteristics of the asset or liability as market participants would. Such conditions would include the condition and location of the asset and any restrictions on its sale or use. Further, it is not relevant if the entity insists that prices are too low relative to its own valuation of the asset and that it would be unwilling to sell at low prices. Prices to be used are those in 'an orderly transaction'. An orderly transaction is one that assumes exposure to the market for a period before the date of measurement to allow for normal marketing activities and to ensure that it is not a forced transaction. If the transaction is not 'orderly', then there will not have been enough time to create competition and potential buyers may reduce the price that they are willing to pay. Similarly, if a seller is forced to accept a price in a short period of time, the price may not be representative. It does not follow that a market in which there are few transactions is not orderly. If there has been competitive tension, sufficient time and information about the asset, then this may result in a fair value for the asset.

IFRS 13 does not specify the unit of account for measuring fair value. This means that it is left to the individual standard to determine the unit of account for fair value measurement. A unit of account is the single asset or liability or group of assets or liabilities. The characteristic of an asset or liability must be distinguished from a characteristic arising from the holding of an asset or liability by an entity. An example of this is that if an entity sold a large block of shares, it may have to do so at a discount to the market price. This is a characteristic of holding the asset rather than of the asset itself and should not be taken into account when fair valuing the asset.

Fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability. The principal market is the one with the greatest volume and level of activity for the asset or liability that can be accessed by the entity.

The most advantageous market is the one which maximises the amount that would be received for the asset or minimises the amount that would be paid to transfer the liability after transport and transaction costs.

An entity does not have to carry out an exhaustive search to identify either market but should take into account all available information. Although transaction costs are taken into account when identifying the most advantageous market, the fair value is not after adjustment for transaction costs because these costs are characteristics of the transaction and not the asset or liability. If location is a factor, then the market price is adjusted for the costs incurred to transport the asset to that market. Market participants must be independent of each other and knowledgeable, and able and willing to enter into transactions.

IFRS 13 sets out a valuation approach, which refers to a broad range of techniques, which can be used. These techniques are threefold. The market, income and cost approaches.

(ii) When measuring fair value, the entity is required to maximise the use of observable inputs and minimise the use of unobservable inputs. To this end, the standard introduces a fair value hierarchy, which prioritises the inputs into the fair value measurement process.

Level 1 inputs are quoted prices (unadjusted) in active markets for items identical to the asset or liability being measured. As with current IFRS, if there is a quoted price in an active market, an entity uses that price without adjustment when measuring fair value. An example of this would be prices quoted on a stock exchange. The entity needs to be able to access the market at the measurement date. Active markets are ones where transactions take place with sufficient frequency and volume for pricing information to be provided. An alternative method may be used where it is expedient. The standard sets out certain criteria where this may be applicable. For example, where the price quoted in an active market does not represent fair value at the measurement date. An example of this may be where a significant event takes place after the close of the market such as a business reorganisation or combination.

The determination of whether a fair value measurement is level 2 or level 3 inputs depends on whether the inputs are observable inputs or unobservable inputs and their significance.

Level 2 inputs are inputs other than the quoted prices in level 1 that are directly or indirectly observable for that asset or liability. They are quoted assets or liabilities for similar items in active markets or supported by market data. For example, interest rates, credit spreads or yield curves. Adjustments may be needed to level 2 inputs and if this adjustment is significant, then it may require the fair value to be classified as level 3.

Level 3 inputs are unobservable inputs. The use of these inputs should be kept to a minimum. However, situations may occur where relevant inputs are not observable and therefore these inputs must be developed to reflect the assumptions that market participants would use when determining an appropriate price for the asset or liability. The entity should maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The general principle of using an exit price remains and IFRS 13 does not preclude an entity from using its own data. For example, cash flow forecasts may be used to value an entity that is not listed. Each fair value measurement is categorised based on the lowest level input that is significant to it.

(b)

Year to 31 December 2012	Asian Market	European Market	Australasian Market
Volume of market – units	4 million	2 million	1 million
Price	$19	$16	$22
Costs of entering the market	($2)	($2)	(n/a) see note
Potential fair value	$17	$14	$22
Transaction costs	($1)	($2)	($2)
Net profit	$16	$12	$20

Note: As Jayach buys and sells in Australasia, the costs of entering the market are not relevant as these would not be incurred. Further transaction costs are not considered as these are not included as part of the valuation.

The principal market for the asset is the Asian market because of the fact that it has the highest level of activity due to the highest volume of units sold. The most advantageous market is the Australasian market because it returns the best profit per unit. If the information about the markets is reasonably available, then Jayach should base its fair value on prices in the Asian market due to it being the principal market, assuming that Jayach can access the market. The pricing is taken from this market even though the entity does not currently transact in the market and is not the most advantageous. The fair value would be $17, as transport costs would be taken into account but not transaction costs.

If the entity cannot access the Asian or European market, or reliable information about the markets is not available, Jayach would use the data from the Australasian market and the fair value would be $22. The principal market is not always the market in which the entity transacts. Market participants must be independent of each other and knowledgeable, and able and willing to enter into transactions.

Input	Amount ($ 000)
Labour and material cost	2,000
Overhead (30%)	600
Third party mark-up – industry average (20% of 2,600)	520
Total	3,120
Annual inflation rate (3,120 x 5% compounded for three years)	492
Total	3,612
Risk adjustment – 6%	217
Total	3,829
Discounted at risk free rate of government bonds plus entity's non-performance risk – 6%	3,215

The fair value of a liability assumes that it is transferred to a market participant at the measurement date. In many cases there is no observable market to provide pricing information. In this case, the fair value is based on the perspective of a market participant who holds the identical instrument as an asset. If there is no corresponding asset, then a valuation technique is used. This would be the case with the decommissioning activity. The fair value of a liability reflects any compensation for risk and profit margin that a market participant might require to undertake the activity plus the non-performance risk based on the entity's own credit standing. Thus the fair value of the decommissioning liability would be $3,215,000.

			Marks
1	(a)	Property, plant and equipment	5
		Goodwill	5
		Intangible assets	1
		Investment in Puttin	4
		Current assets	1
		Disposal group	5
		Retained earnings	6
		Other components of equity	4
		Non-controlling interest	3
		Current liabilities	1
			35
	(b)	1 mark per point up to maximum – definition	4
		Discussion	3
	(c)	Accounting treatment	4
		Ethical considerations	4
			50
2	(a)	1 mark per point up to maximum	7
	(b)	1 mark per point up to maximum	5
	(c)	1 mark per point up to maximum	6
	(d)	1 mark per point up to maximum	5
	Professional marks		2
			25
3	(a)	1 mark per point up to maximum	7
	(b)	1 mark per point up to maximum	6
	(c)	1 mark per point up to maximum	4
	(d)	1 mark per point up to maximum	6
	Professional marks		2
			25
4	(a)	(i) 1 mark per point up to maximum	7
		(ii) IFRS 13 hierarchy	6
	(b)	1 mark per point up to maximum	6
		Calculations	4
	Professional marks		2
			25