Answers

1 (a)

Jocatt Group
Cash Flow Statement for the year ended 30 November 2010

	€m	€m
Cash flow from operating activities (note 1)		289·5
Returns on investment and servicing of finance (note 2)		(16·4)
Taxation (w (iv))		(16·5)
Capital expenditure and financial investment (note 3)		(102)
Acquisitions and disposals (note 4)		(58·6)
Equity dividends paid		(5)
Cash inflow before use of liquid resources and financing		91
Financing:		
Repayment of long-term loan	(4)	
Rights issue minority interest	2	
		(2)
Net increase in cash in period		89

Notes

1 Cashflow from operating activities:

	€m	€m
Operating profit (57·5 – 6 – 9 + 6)		48·5
Adjustments to operating activities:		
Retirement benefit expense (working (vii))	4	
Depreciation on fixed assets	27	
Loss on replacement of investment property component part (working (viii))	0·5	
Amortisation of intangible assets (working (ix))	17	
Impairment of goodwill (working (i))	31·5	
Cash paid to retirement benefit scheme (working (vii))	(7)	
Decrease in debtors (113 – 62 + 5)	56	
Decrease in stocks (128 – 105)	23	
Increase in creditors (144 – 55)	89	
		241·0
Net cash flow from operating activities		289·5

2 Returns on investment and servicing of finance

	€m
Interest paid	(6)
Minority interest dividend (working (v))	(10·4)
	(16·4)

3 Capital expenditure and financial investment

	€m
Purchase of fixed assets (working (vi))	(98)
Additions – investment property (working (viii))	(1)
Proceeds from sale of land (working (vi))	15
Intangible assets (working (ix))	(12)
Purchases of AFS investments (working (x))	(6)
	(102)

4 Acquisitions and disposals

	€m
Purchase of associate (working (iii))	(48)
Purchase of subsidiary (17·6 – 7) (working (ii))	(10·6)
	(58·6)

Workings

(i) Tigret goodwill

	€m
1 December 2009 – consideration	32·6
Cost of equity interest held before business combination	5
Purchase consideration	37·6
Identifiable net assets (45 x 60%)	(27)
Deferred tax (45 – 40) x 30% x 60%	0·9
Goodwill	11·5

Therefore goodwill is impaired by €68m plus €11·5m minus €48m i.e. €31·5m

(ii) Purchase of subsidiary

The purchase of the subsidiary is adjusted for in the cash flow statement by eliminating the assets acquired, as they were not included in the opening balances. The effect of the purchase is as follows:

	Dr (€m)	Cr (€m)
Fixed assets	15	
Intangible assets	18	
Debtors	5	
Cash	7	
Goodwill	11·5	
AFS investments		5
Share capital		15
Cash		17·6
MI (net assets 45 – deferred tax 1·5 x 40%)		17·4
Deferred tax		1·5
	56·5	56·5

(iii) Associate

	€m
Opening balance at 1 December 2009	Nil
Profit for period	6
Cost of acquisition (cash)	48
Closing balance at 30 November 2010	54

(iv) Taxation

	€m	€m
Opening tax balances at 1 December 2009:		
Deferred tax	41	
Current tax	30	
		71
Deferred tax on acquisition		1·5
Charge for year (11 + 1)		12
Less closing tax balances at 30 November 2010:		
Deferred tax	35	
Current tax	33	
		(68)
Cash paid		16·5

The tax charge on the AFS financial asset gain (€1m) is adjusted on the tax charge for the year.

(v) Minority Interest

	€m
Opening balance at 1 December 2009	36
On acquisition	17·4
Current year amount	10
Dividend paid	(10·4)
Rights issue (5 x 40%)	2
Closing balance at 30 November 2010	55

The receipt from the rights issue is a cash inflow into the group and should be shown as a financing activity. Therefore the dividend paid will be €10·4 million and the cash from the rights issue will be €2 million.

(vi) Fixed assets

Opening balance at 1 December 2009	254
Revaluation loss	(7)
Plant in exchange transaction	4
Sale of land	(10)
Depreciation	(27)
On acquisition of Tigret	15
Current year additions	98
Closing balance at 30 November 2010	327

The profit on the sale of the land is €15m plus €4 million minus carrying value €10 million, i.e. €9 million

(vii) Defined benefit scheme

Opening balance at 1 December 2009		22
Current service costs	10	
Past service costs	2	
Expected return on assets	(8)	
Charge to profit and loss account		4
Actuarial losses		6
Contributions paid		(7)
Closing balance at 30 November 2010		25

(viii) Investment property

Opening balance at 1 December 2009	6
Acquisition	1
Disposal	(0·5)
Gain	1·5
Closing balance at 30 November 2010	8

(ix) Intangible assets

Opening balance at 1 December 2009	72
Acquisitions (8 + 4)	12
Tigret	18
Amortisation	(17)
Closing balance at 30 November 2010	85

(x) Available for sale financial assets

Opening balance at 1 December 2009	90
Acquisitions (cash)	6
Tigret	(5)
Gain (including tax)	3
Closing balance at 30 November 2010	94

(xi) Share capital

Opening balance at 1 December 2009	275
Acquisition of Tigret	15
Closing balance at 30 November 2010	290

(b) (i) The vast majority of companies use the indirect method for the preparation of cash flow statements. Most companies justify this on the grounds that the direct method is too costly. The direct method presents major categories of gross cash inflows and outflows on the face of the cash flow statement. The indirect method shows the same operating cash flows except that the net figure is produced by adjusting operating profit for non-cash items and bringing in cash flows relating to any provision in respect of operating items, whether or not the provision was included in operating profit. The direct method shows cash from operations made up from individual operating cash flows. Users often prefer the direct method because it shows the major categories of cash flows whilst preparers of financial statements prefer the indirect method as it is relatively easier to prepare. The complicated adjustments required by the indirect method are difficult to understand and provide entities with more leeway for manipulation of cash flows. The adjustments made to reconcile net profit before tax to cash from operations are confusing to users. In many cases these cannot be reconciled to observed changes in the balance sheet. Thus users will only be able to understand the size of the difference between

operating profit and cash from operations. The direct method allows for reporting operating cash flows by understandable categories as they can see the amount of cash collected from customers, cash paid to suppliers, cash paid to employees and cash paid for other operating expenses. Users can gain a better understanding of the major trends in cash flows and can compare these cash flows with those of the entity's competitors.

An issue for users is the abuse of the classifications of specific cash flows. Misclassification can occur amongst the sections of the statement. Cash outflows that should have been reported in the operating section may be classified as returns on investments and servicing of finance with the result that companies enhance operating cash flows. The complexity of the adjustments to net profit before tax can lead to manipulation of cash flow reporting. Information about cash flows should help users to understand the operations of the entity, evaluate its financing activities, assess its liquidity or solvency or interpret earnings information. A problem for users is the fact that entities can choose the method used and there is not enough guidance on the classification of cash flows in the various sections of the indirect method used in FRS 1.

(ii) The directors wish to manipulate the cash flow statement in order to enhance their income. As stated above, the indirect method lends itself more easily to the manipulation of cash flows because of the complexity of the adjustments to net profit before tax and the directors are trying to make use of the lack of accounting knowledge of many users of accounts who are not sophisticated in their knowledge of cash flow accounting.

Corporate reporting involves the development and disclosure of information, which the entity knows is going to be used. The information has to be truthful and neutral. 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. The directors must consider how to best apply accounting standards even when faced with issues that could cause them to lose income. The directors should not pursue self-interest or fail to maintain objectivity and independence, and must act with appropriate professional judgement. Therefore the proceeds of the loan should be reported as cash flows from financial activities.

2 **(a)** The arrangement is not within the scope of FRS 20 'Share-based payment' because the contract may be settled net and has not been entered into in order to satisfy Margie's expected purchase, sale or usage requirements. Margie has not purchased the wheat but has entered into a financial contract to pay or receive a cash amount. The arrangement should be dealt with in accordance with FRS 26 'Financial Instruments: Recognition and measurement'.

Contracts to buy or sell non-financial items are within the scope of FRS 26 if they can be settled net in cash or another financial asset and are not entered into and held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements. Contracts to buy or sell non-financial items are inside the scope if net settlement occurs. The following situations constitute net settlement:

(a) the terms of the contract permit either counterparty to settle net;
(b) there is a past practice of net settling similar contracts;
(c) there is a past practice, for similar contracts, of taking delivery of the underlying and selling it within a short period after delivery to generate a profit from short-term fluctuations in price, or from a dealer's margin; or
(d) the non-financial item is readily convertible to cash.

The contract will be accounted for as a derivative and should be valued at fair value (asset or liability at fair value). Initially the contract should be valued at nil as under the terms of a commercial contract the value of 2,500 shares should equate to the value of 350 tonnes of wheat. At each period end the contract would be revalued and it would be expected that differences will arise between the values of wheat and Margie shares as their respective market values will be dependent on a number of differing factors. The net difference should be taken to profit or loss.

As Margie has no intention of taking delivery of the wheat, this does not appear to be a hedging contract as no firm commitment exists to purchase, neither is this a highly probable forecast transaction.

(b) Share-based payment awards exchanged for awards held by the acquiree's employees are measured in accordance with FRS 20 'Share-based payment'. If the acquirer is obliged to replace the awards, some or all of the fair value of the replacement awards must be included in the consideration. The amount not included in the consideration will be recognised as a compensation expense. If the acquirer is not obliged to exchange the acquiree's awards, the acquirer does not adjust the consideration even if the acquirer does replace the awards. A portion of the fair value of the award granted by Margie is accounted for in the cost of the business combination and a portion under FRS 20, even though no post-combination services are required. The amount included in the cost of the business combination is the fair value of Antalya's award at the acquisition date (€20 million). Any additional amount, which in this case is €2 million, is accounted for as a post-combination expense under FRS 20. This amount is recognised immediately as a post-combination expense because no post-combination services are required.

(c) The shares issued to the employees were issued in their capacity as shareholders and not in exchange for their services. The employees were not required to complete a period of service in exchange for the shares. Thus the transaction is outside the scope of FRS 20.

As regards the purchase of the building, Grief did not act in its capacity as a shareholder as Margie approached the company with a proposal to buy the building. Grief was a supplier of a building and as such the transaction comes under FRS 20. The building is valued at fair value with the equity being credited with the same amount.

(d) Where the vesting period is linked to a market performance condition, an entity should estimate the expected vesting period. If the actual vesting period is shorter than estimated, the charge should be accelerated in the period that the entity delivers the cash or equity instruments to the counterparty. When the vesting period is longer, the expense is recognised over the originally estimated vesting period. The effect of a vesting condition may be to change the length of the vesting period. In this case, paragraph 15 of FRS 20 'Share-based payment' requires the entity to presume that the services to be rendered by the employees as consideration for the equity instruments granted will be received in the future, over the expected vesting period. Hence, the entity will have to estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a market condition, the estimate of the length of the expected vesting period must be consistent with the assumptions used in estimating the fair value of the share options granted and is not subsequently revised.

Margie expects the market condition to be met in 2011 and thus anticipates that it will charge €1 million per annum until that date (100 x 4,000 x €10 divided by 4 years). As the market condition has been met in the year to 30 November 2010, the expense charged in the year would be €2 million (€4 million – €2 million already charged) as the remaining expense should be accelerated and charged in the year.

3 **(a)** FRS 12 paragraph 14, states that an entity must recognise a provision if, and only if:

(i) a present obligation (legal or constructive) has arisen as a result of a past event (the obligating event),
(ii) payment to settle the obligation is probable ('more likely than not'), and
(iii) the amount can be estimated reliably.

An obligating event is an event that creates a legal or constructive obligation and, therefore, results in an entity having no realistic alternative but to settle the obligation.

At the date of the financial statements, there was no current obligation for Greenie. In particular, no action had been brought in connection with the accident. It was not yet probable that an outflow of resources would be required to settle the obligation.

Greenie may need to disclose a contingent liability. FRS 12 defines a contingent liability as:

(a) a possible obligation that has arisen from past events and whose existence will be confirmed by the occurrence or not of uncertain future events; or
(b) a present obligation that has arisen from past events but is not recognised because:
  (i) it is not probable that a transfer of economic benefits will be required to settle the obligation; or
  (ii) the amount of the obligation cannot be measured with sufficient reliability.

FRS 12 requires that entities should not recognise contingent liabilities but should disclose them, unless the possibility of an outflow of economic resources is remote. It appears that Greenie should disclose a contingent liability. The fact that the real nature and extent of the damages, including whether they qualify for compensation and details of any compensation payments remained to be established all indicated the level of uncertainty attaching to the case. The degree of uncertainty is not such that the possibility of an outflow of resource could be considered remote. Had this been the case, no disclosure under FRS 12 would have been required.

Thus the conditions for establishing a liability are not fulfilled. However, a contingent liability should be disclosed as required by FRS 12.

The possible recovery of these costs from the insurer give rise to consideration of whether a contingent asset should be disclosed. Given the status of the expert report, any information as to whether judicial involvement is likely will not be available until 2011. Thus this contingent asset is more possible than probable. As such no disclosure of the contingent asset should be included.

(b) Greenie appears to have significant influence over Manair, and therefore, it should be accounted for as an associate. According to paragraph 4 of FRS 9 'Associates and joint ventures', an associate is an entity (other than a subsidiary) in which the investor has a participating interest and over whose operating and financial policies the investor exercises a significant influence.

A participating interest is an interest held in the shares of another entity held on a long-term basis for the investor's benefit and is linked to the exercise of significant influence over the investee's operating and financial policies. A shareholding of 20% of the ordinary shares of an entity is presumed to be a participating interest.

Significant influence is the involvement of the investor in the policy decisions of the entity such as the expansion of the business, changes in products, markets and activities and dividend policy. Where an investor holds 20% or more of the voting power of the investee, it is presumed that the investor has a participating interest unless it can be clearly demonstrated that this is not the case.

In certain cases, whether significant influence exists should also be assessed when an investor holds less than 20% especially where it appears that the substance of the arrangement indicates significant influence. Greenie holds 19·9% of the voting

shares and it appears as though there has been an attempt to avoid accounting for Manair as an associate. The fact that one investor holds a majority share of the voting power can indicate that other investors do not have significant influence. A substantial or majority ownership by an investor does not, however, necessarily preclude other investors from having significant influence. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

(i) representation on the board of directors or equivalent governing body of the investee;
(ii) participation in the policy-making process;
(iii) material transactions between the investor and the investee;
(iv) interchange of managerial personnel; or
(v) provision of essential technical information.

The shareholders' agreement allows Greenie to participate in some decisions. It needs to be determined whether these include strategic decisions of Manair, although this is very likely. The representation on the board of directors combined with the additional rights Greenie had under the shareholders' agreement, give Greenie the power to participate in some policy decisions. Additionally, Greenie had sent a team of management experts to give business advice to the board of Manair.

In addition, there is evidence of material transactions between the investor and the investee and indications that Greenie provided Manair with maintenance and technical services. Both of these facts are examples of how significant influence might be evidenced.

Based on an assessment of all the facts, it appears that Greenie has significant influence over Manair and that Manair should be considered an associate and accounted for using the equity method of accounting.

Finally, as it is likely that Manair is an associated undertaking of Greenie, the transactions themselves would be deemed related party transactions. Greenie would need to disclose within its own financial statements the relationship, an outline of the transactions including their total value, outstanding balances including any debts deemed irrecoverable or doubtful.

(c) The franchise right should be recognised using the principles in FRS 20 'Share-based payment'. The asset should be recognised at the fair value of the rights acquired and the existence of exchange transactions and prices for similar franchise rights means that a fair value can be established. The franchise right should therefore be recorded at €2·3 million. If the fair value had not been reliably measurable then the franchise right would have been recorded at the fair value of the equity instruments issued, i.e. €2·5 million

Normally irredeemable preference shares would be classified as equity. The contractual obligation to pay the fixed cash dividend creates a liability component and the right to participate in ordinary dividends creates an equity component. If Greenie were to comply with FRS 25 'Financial instruments: Presentation', it would require the preference shares to be treated as compound financial instruments with both an equity and liability component. The value of the equity component is the residual amount after deducting the separately determined liability component from the fair value of the instrument as a whole.

Under FRS 25, it would seem that substantially all of the carrying value of Greenie's preference shares would be allocated to the liability component because of the dividend elements and the fixed net cash dividend would be treated as a finance cost.

Departure from a requirement of a standard is allowed only in the extremely rare circumstances where it would affect the true and fair view of the financial statements. Greenie's argument that the presentation of the preference shares in accordance with FRS 25 would be misleading, is not acceptable. The fact that it would not reflect the nature of the instruments as having characteristics of permanent capital providing participation in future profits is not a valid argument. Additional disclosure is required when compliance with the specific requirements in FRS is insufficient to enable a user to understand the impact of particular transactions or conditions on financial position and financial performance. A fair presentation would be achieved by complying with FRS 25 and providing additional disclosures to explain the characteristics of the preference shares.

4 (a) (i) There are several approaches which could have been taken in developing standards for SMEs. One course of action would have been for RoI GAAP for SMEs to be developed on a national basis, with international standards focusing on accounting for listed company activities. The main issue would be that the practices developed for SMEs may not be consistent and may lack comparability across national boundaries. Additionally, if a SME wishes to list its shares on a capital market, the transition to international standards would be more difficult.

Another approach would be to detail the exemptions given to smaller entities in the mainstream accounting standards. For example, an appendix would be included within the standard detailing the exemptions given to smaller entities.

A third approach would be to introduce a separate set of standards comprising all the issues addressed in standards, which are relevant to SMEs. This approach would be more 'user friendly' for the preparers of SMEs as they only need to refer to this independent set of standards.

Finally, a self-contained set of accounting principles that are based on full standards could be created. The standards would be simplified so that they are suitable for SMEs. This would create separate and distinct frameworks which would be applied in full and without the choice of the most suitable accounting policy from full standards or the SME standard.

The latter is naturally a modified version of the full standard, and not an independently developed set of standards being based on recognised concepts and principles which should allow easier transition to full accounting standards if the SME decides to become a public listed entity.

The principal aim when developing accounting standards for small to medium-sized entities (SMEs) is to provide a framework that generates relevant, reliable, and useful information. The result should be a high quality and understandable set of accounting standards suitable for SMEs. The users of financial statements are likely to be different for SMEs compared to multinational companies. Where there is no public disclosure, the only groups likely to receive the information are management, shareholders, and perhaps government agencies.

There are a number of accounting standards and disclosures that probably do not provide useful information for the users of SME financial statements, such as the requirement to produce consolidated accounts, to provide for deferred taxation, and to recognise profits on long-term contracts. In deciding on the modifications to make to accounting standards, the needs of the users will have to be taken into account, as well as the costs and other burdens imposed upon SMEs. Relaxation of some of the measurement and recognition criteria has to be made in order to achieve the reduction in these costs and burdens. Some disclosure requirements are intended to meet the needs of listed entities, or to assist users in making forecasts of the future. Users of financial statements of SMEs often do not make such kinds of forecasts. There is a major problem in the development and implementation of such standards. It cannot be assumed that the statements of principles and the underlying theory and principles, which are based on the information needs of large public company stakeholders, apply equally to SMEs. Small companies pursue different strategies, and their goals are more likely to be survival and stability rather than growth and profit maximisation. The stewardship function is often absent in small companies, with the accounts playing an agency role between the owner-manager and the bank.

In Ireland and the UK, the development of Financial Reporting Standards for Smaller Entities (FRSSE) led to the 'Big GAAP, Little GAAP' debate. This gives rise to the question of whether a different basis of 'true and fair view' should be allowed to exist within the same jurisdiction.

The most important difference between an SME and a listed public company lies in the nature of ownership. The former is characterised by the entrepreneur or family investing their own capital and running the business. The latter is always run by directors acting on behalf of institutional investors who own the majority of shares. It is this divorce of ownership and control that creates the need for directors to be held accountable to shareholders, and to adhere to the disclosure requirements laid down by law and standard setters.

(ii) The main argument for separate SME accounting standards is the undue cost burden of reporting, which is proportionately heavier for smaller firms. The cost burden of applying a full set of accounting standards may not be justified on the basis of user needs. This is because the main users of SME reports are easily identified and are few in number. Further, much of the current reporting framework is based on the needs of large business, so SMEs perceive that the full statutory financial statements are less relevant to the users of SME accounts. SMEs also use financial statements for a narrower range of decisions, as they have less complex transactions and therefore less need for the sophisticated analysis of financial statements.

The main argument against different reporting requirements for SMEs (differential reporting) is that if accounting rules are not held to apply universally, then users of accounts may lose confidence in the rules and it may lead to a two-tier system of reporting. Companies should not be subject to different rules which could give rise to different 'true and fair views'. However, this assumes that the users are different, which may not be the case, and that the users are too inflexible to understand different accounting bases. Accounting rules already have many areas of choice.

Other arguments against differential reporting include the need for comparability and reliability. Additionally, there is an argument that full statutory financial statements are in the public interest, not only for users but also as a measure of protection for minority shareholders and other stakeholders, satisfying some of their information needs.

The accounting needs of a small business are simple, but as the business gets bigger, so does its need for more sophisticated internal information and disclosure to the outside world. The question arises as to whether SME standards should apply to all unlisted entities, or just those listed entities below a certain size. There are arguments for using the legal form of a company as a basis, but firms with different legal forms often have similar economic structures and hence the legal form does not reflect actual economic substance.

An entity's size may not be the ideal criterion for differential reporting because it is relative and also depends on other factors, such as industry sector. Size is a weak indicator of the costs and benefits of financial reporting, and may not be the best way to determine what an SME is. SMEs could be defined by reference to ownership and the management of the entity, as SMEs are not necessarily just smaller versions of public companies. However, the main characteristic which distinguishes SMEs from other entities is the degree of public accountability, and so the definition of what constitutes an SME has to revolve around those entities that do not have public accountability. It would not be practical to determine globally-applicable values, because the definition of what constitutes an SME will vary from country to country. Therefore, it should be left to individual countries to adopt measures that reflect their local economic and social environment. There is no universally-agreed definition of an SME. No single definition can capture all the dimensions of a small or medium-sized business, or cannot be expected to reflect the differences between firms, sectors, or countries at different levels of development. Most definitions based on size use measures such as number of employees, balance sheet total, or annual turnover.

(b) (i) The accounting of the land and buildings is currently accountable under FRS 11 *Impairment of fixed assets and goodwill* and FRS 15 *Tangible fixed assets*. As the property is non-specialised and there is a policy of revaluation it should be valued at existing use value. Where there is evidence of impairment such as the temporary decline a revalued property must be valued at the lower of existing use value and recoverable amount (FRS 15 para 54). Therefore the building element would be depreciated by €0·28 million (€14 million/50 years) resulting in a net book value of €14·22 million (€16 million less €1·5 million less €0·28 million). As there is evidence of impairment the asset would be valued at the higher of value in use of €10·7 million (€1·5 million + €9·2 million) and net selling price of €9·75 million ((€1·5 million + €8·5 million) x 97·5%), so €10·7 million, giving a loss of €3·52 million (€14·22 million less €10·7 million). This is where similarity between IFRS and RoI GAAP ends. Under RoI GAAP, because the building is non-specialised and a policy of revaluation exists and existing use value of €9·3 million (€1·5 million + €7·8 million) is lower than recoverable amount, the building requires to be further written down by €1·4 million (€10·7 million less €9·3 million). The total loss of €4·92 million would be allocated as follows:

- From initial carrying amount of €14·22 million to depreciated historic cost (not given) should be sent to equity
- From depreciated historic cost to recoverable amount of €10·7 million to profit and loss
- From recoverable amount of €10·7 million to €9·3 million to equity

RoI GAAP results in additional losses over and above IFRS, therefore IFRS would give a better result for the stock exchange listing.

(ii) Investment properties.

The property is currently accounted for under SSAP 19 *Investment Properties*. The property would be revalued at each accounting period end with any gains or losses (unless deemed permanent) taken to equity. Permanent diminutions in value would be taken to the profit and loss account. SSAP 19 does not require the asset to be depreciated therefore €1 million (€10 million less €9 million) is the surplus on revaluation shown within equity as at 1 November 2009 (land €0·8 million (€9·5 million less €8·7 million) and hotel €0·2 million (€0·5 million less €0·3 million)).

The market value is the best price reasonably obtainable by the buyer. The 'highest and best use' value may result in the fair value being determined on the basis of the redevelopment of the site. Any future capital expenditure that would be undertaken to get the investment property to its highest and best use by third parties should be reflected in the property's fair value but not if the work is to be undertaken by the owner. As at 30 November 2010, the 'highest and the best value' is €15 million which can be obtained for the land for its potential use. As the building will be demolished, none of the value need be allocated to the building. Additionally, there would be no point in spending additional monies on demolishing the building as the cost outweighs the increase in value. The land would be valued at €15 million and the building at zero. The loss on the building is €0·5 million of which €0·2 million would be taken against the revaluation reserve with the balance to profit and loss. The land component would be subject to an uplift of €5·5 million (€15 million less €9·5 million) all of which would be shown within the revaluation reserve. Deferred taxation would not be provided as there was not a binding sale agreement.

IFRS allows a company to choose either fair value or depreciated cost as an accounting policy for measuring investment property. The company wishes to obtain a Stock Market listing and therefore it would appear to be more beneficial to show holding gains in profit and loss, and therefore the fair value model will be used.

Where fair value is used, gains and losses are recognised in the profit and loss account. Therefore, had Havata adopted IFRS then it would not have been necessary to consider the land and hotel separately as the gains and losses on both the components should be posted to profit and loss. Under IFRS deferred tax is applicable and hence the gains would be chargeable to 30% deferred taxation. A net gain of €0·7 million would be shown in the year ended 30 November 2009 (hence brought forward reserves as at 1 December 2009) and €3·5 million (€5 million less 30% deferred taxation) in the year ended 30 November 2010.

			Marks
1	**(a)**	Operating Profit	4
		Retirement benefit expense	2
		Depreciation on fixed assets	1
		Depreciation on investment property	1
		Amortisation of intangible assets	1
		Impairment of goodwill	4
		Decrease in trade debtors	2
		Decrease in stocks	1
		Increase in trade creditors	1
		Cash paid to retirement benefit scheme	1
		Interest paid	1
		Tax paid	2
		Purchase of associate	2
		Purchase of fixed assets	2
		Purchase of subsidiary	1
		Additions – investment property	1
		Proceeds from sale of land	1
		Intangible assets	1
		Purchases of AFS investments	1
		Repayment of long-term borrowings	1
		Rights issue MI	1
		Minority interest dividend	1
		Dividends paid	1
		Net increase in cash	1
			35
	(b)	**(i)** Subjective	7
		(ii) Subjective	6
		Professional	2
			50
2	**(a)**	Discussion FRS 26	5
		Conclusion	2
	(b)	Discussion of FRS 20	4
		Calculation	2
	(c)	Discussion of FRS 20	4
	(d)	Discussion of FRS 20	4
		Calculation	2
		Professional	2
			25
3	**(a)**	Provision discussion	3
		Contingent liability discussion	3
	(b)	Significant influence discussion and application	10
	(c)	Intangible assets	3
		Preference shares	4
		Professional	2
			25

			Marks
4	**(a)**	Subjective assessment	13
		Professional	2
	(b)	Subjective assessment	10
			25