ANSWER

Chuckle

Q (a) (i) Using exhibit 1 only, discuss why Grin Co should be classified as an associate, and not a subsidiary, on 1 April 20X4.

(4 marks)

A

Chuckle should classify Grin as an associate, rather than a subsidiary, where it will have only significant influence over the financial and operating policy decisions and not have the power and ability to control them.

Chuckle has acquired 30% of the equity shares of Grin. A holding in excess of 20% but not a majority creates the rebuttable assumption of significant influence.

Further evidence to support the existence of significant influence is that Chuckle and Grin share some key management personnel.

Whilst it is possible to control an entity whilst holding less than 50% of the voting rights, it is explicitly stated in the question that the other shareholders have voted independently in the past as Chuckle is unable to directly influence them.

In conclusion it was correct to classify Grin Co as an associate.

ANSWER
Chuckle

Q (a) (ii) Using exhibit 1 only, explain how Grin Co should be accounted for as an associate using the equity method in the consolidated statement of financial position of Chuckle Co at 31 March 20X6.

(3 marks)

A

As an associate Grin should have been equity accounted in the group accounts from when the investment was made in 20X4. It should not still be carried at cost in 20X6.

This has been a material fundamental error. This means that there should be a prior period adjustment. The opening equity and last year's comparatives will be restated.

Applying equity accounting means that the initial investment in Grin should be increased to recognise Chuckle's 30% share of the post acquistion retained profits as represented by the rise in the net assets.

$100m + (30% x ($348m - $286m)) = $118.6m

The increase of $18.6 million should also be included within the Chuckle group's consolidated retained earnings.

If you like journals – but NOT required.

Dr Investment in Associate	*$18.6m*	
Cr RE		*$18.6m*

ANSWER

Chuckle

Q (b) Using exhibit 2, explain briefly why the classification of Chuckle Co's investment in Grin Co should change on 1 April 20X6 to that of a subsidiary.

(3 marks)

A

Chuckle's purchase of an additional 18% (to bring the holding in Grin to 48%) and the acquistion of potential voting rights through the options, combine to give Chuckle control over Grin. Chuckle has the power over Grin's financial and operating activities, exposure to variable returns and the ability to use that power.

Whilst Chuckle does not hold a majority of the shares, it is by far the largest with 48%. It is noted that none of the other shareholders hold more than 10%. They are not colluding with each other. Chuckle is able to divide and rule.

Further the options to buy potential voting rights are both currently exercisable and in the money. As such they are substantive. This contributes to the assessment that Chuckle controls Grin.

Q (c) (i) Using exhibit 2, explain briefly how the additional purchase of the 18% equity in Grin Co should be accounted for in the consolidated financial statements of Chuckle Co.

(2 marks)

A

Chuckle's additional purchase of the 18% equity is a step acquisition. Grin is a new subsidiary. Acquisition accounting commences. Goodwill is determined.

There will be a 52% NCI reported! Assets and liabilities of Grin will be remeasured to their fair value and fully consolidated into the group accounts. The investment in the associate will be derecognised.

In calculating goodwill, the carrying value of the original 30% holding is remeasured to fair value. The difference with the carrying value will be a gain that is recognised in group profit.

P's investment	$m
30% CV	118.6
Balancing figure to profit	8.4
30% FV	127

ANSWER

Chuckle

Q (c) (ii) Using exhibit 3, explain how the fair value of the non-current and current assets of Grin Co at 1 April 20X6 (including any deferred tax adjustments) should be calculated.

(6 marks)

A

The net assets of the subsidiary Grin will have to be remeasured at fair value at the date of acquisition. This is necessary to determine goodwill correctly.

Fair value is basically market value. Fair value is the amount expected to be received on the sale of an asset in an orderly sale between informed and willing parties.

Where the fair value increases the carrying value of an asset, no current tax is assessed, and the tax base remains unchanged. As such a taxable temporary difference arises and a corresponding deferred tax liability. The deferred tax is a further fair value adjustment.

The database of customer lists cannot be not recognised as an asset in the individual financial statements of Grin Co. On acquisition though, Chuckle Co should recognise the database as a separate intangible asset from goodwill in the group accounts. It is identifiable.

Deferred tax

	FV		CV	Taxable temporary difference and fair value adjustment on the asset	Tax rate	Deferred tax liability and fair value adjustment creating a liability
PPE	60	less	50	10		
Inventory	131	less	84	47		
Intangible	5	less	nil	5		
				62	X 20%	12.4

Goodwill	$m
P's Investment	118.6
30% FV	127
18% Investment	66
NCI (52% x 397.6)	206.8
FV of net assets (348 + 62 FVA – 12.4 DTL)	(397.6)
Goodwill	2

ANSWER

Chuckle

Q ((c) (iii) Using the pre-populated spreadsheet response option with exhibit 3 and your previous answers, adjust the spreadsheet prepared by the directors of Chuckle Co in order to prepare a corrected consolidated statement of financial position at 1 April 20X6.

The spreadsheet should take into account the following: • accounting for the associate using the equity method; • the change in classification from associate to subsidiary; • the fair value adjustments on acquisition; and • goodwill using the proportionate share of net assets method to calculate the non-controlling interest.

(6 marks)

A

	$m	Ass aii	Step ci	Sub cii		$m
Assets						
Non-current Assets						
Property, Plant and equipment	2,021			10		2,031
Investment in Associate	100	18.6	-118.6			0
Further investment in associate	66			-66		0
Goodwill				2		2
Other non-current assets	186			5		191
	2,373					
Current Assets	542			47		589
Total Assets	2,915					**2,813**
Equity						
Equity attributable to equity holders of the company						
Share capital	150					150
Other components of equity	370					370
Retained earnings	1,157	18.6	8.4			1,184
Total Equity	1,677					
Non-Controlling Interest				206.8		207
Grin's equity	348			-348		
Liabilities						
Non-current Liabilities						
Deferred income tax liabilities	314			12.4		326
	662					
Current Liabilities	576					576
Total Liabilities	1,238					
Total equity and Liabilities	2,915					**2,813**

ANSWER

Chuckle

Marking Guide

		Marks
ai)	Discussion of control (IFRS 10 and other factors) vs. significant influence and application to the scenario	4
aii)	explanation of equity accounting and application to the scenario - Calculation of investment in associate - Adjustment to retained earnings	3
b)	explanation of the change of classification to that of subsidiary	3
ci)	explanation of the accounting for the additional 18% (step acquisition)	2
cii)	• application of the discussion to the scenario of the fair value adjustments required: - Land and DTX	2
	• Finished goods and DTX	2
	• Database and DTX	2
ciii)	adjustment of spreadsheet for the following: -	
	• Equity method to 1 April 20X6	1
	• Remove cost of investment	1
	• Gain on step acquisition.	2
	• Impact of revaluation to fair value including DTX	4
	• Goodwill calculation	3
	• NCI	1
Total		**30**