Answers

(a)(i) Significant influence is the ability to participate in the financial and operating policy decisions of the investee but is not control or joint control over these policies. IFRS 10 *Consolidated Financial Statements* states that an investor controls an investee only if the investor has all of the following:

- power over the investee;
- exposure to or rights to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect the amount of the investor's returns.

Control is presumed to exist where the investor has a majority of the voting rights of the investee. This would usually give the investor the ability to direct the relevant activities, i.e. the activities which significantly affect the investee's returns. An ownership of 50% or less of the voting rights does not necessarily preclude an investor from obtaining control.

Chuckle Co only owned 30% of the equity. Where an investor has a significant minority, close consideration should be given as to whether the voting rights alone or whether a combination of factors is deemed sufficient to obtain power. Chuckle Co and Grin Co do share some key management personnel which can sometimes be evidence of control. However, there has been no clear past voting pattern suggesting that Chuckle Co is unable to directly influence the economic decisions of the other investors. None of the other investors owns more than 10% and they have voted independently which also suggests Chuckle Co cannot influence the other investors to the extent it would give them control. With only 30% of the equity and no additional potential rights, it would appear that Chuckle Co was only able to exercise significant influence rather than control. It can be concluded that it was correct to classify Grin Co as an associate.

(a)(ii) Grin Co is an associate and should have been equity accounted for in the consolidated financial statements of Chuckle Co in prior years. Therefore, as Grin Co has not been accounted for as an associate, a prior period adjustment should occur. The general principle in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is that an entity must correct all material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by restating the comparative amounts for the prior period(s) presented in which the error occurred. This will mean that the financial statements for the year ended 31 March 20X6 will be adjusted.

The initial investment is measured at cost and the carrying amount should be increased to recognise the investors' share of the profits and other comprehensive income after the date of acquisition. In the consolidated statement of financial position, one line should be included within non-current assets as investment in associate.

At 31 March 20X6, the investment in associate should be valued at $118.6 million being the initial cost of $100 million already recorded plus 30% of the increase in net assets since the acquisition date ($100m + (30% x ($348m - $286m))) The increase of $18.6 million should also be included within consolidated retained earnings.

(b) The acquisition of the extra 18% of the equity on 1 April 20X6 would now unquestionably make Chuckle Co a significant minority investor. No other investor owns more than 10% of the equity so Chuckle Co owns a much higher proportional share (48%). Where the other shareholdings are owned by a large number of unconnected, dispersed holders, it would be clear that power has been obtained. However, the other shares are owned by just a few other investors which is unlikely to be considered a large, dispersed group of unconnected shareholders.

Potential voting rights should be considered in the assessment of control. For these to be included in the assessment, the rights should be substantive. That would usually mean that they are currently exercisable and have an exercise price which is below the market price of the shares so that they are "in the money". In that sense it is worthwhile for the investor to acquire the extra shares. In the case of Chuckle Co, they own share options that are currently exercisable but not in the money. This is because the exercise price is above the share price of Grin Co. However, they are only just out of the money. In addition, the share price of Grin Co is expected to increase and cost savings are expected from a further acquisition of shares. It seems therefore that the share options would be deemed to be substantive. Since exercising these options would enable Chuckle Co to obtain a 60% shareholding, it can be concluded that Chuckle Co is able to exercise power over Grin Co from 1 April 20X6. Grin Co should be reclassified from an associate to a subsidiary at this date.

(c)(i) The additional purchase of the 18% equity would constitute a piecemeal or step acquisition. Goodwill will be calculated as the amount by which the fair value of the consideration exceeds the fair value of the identifiable net assets on acquisition. Chuckle Co must therefore remeasure its previously held equity interest in Grin Co at its acquisition fair value and recognise the resulting gain or loss in the consolidated statement of profit or loss. Goodwill will be calculated by including both the fair value of the previously held equity interest and the fair value of the additional consideration.

(c)(ii) It is necessary for the calculation of goodwill that Chuckle Co measures the identifiable assets acquired and the liabilities assumed at their acquisition date fair values. IFRS 13 *Fair value Measurement* should be considered in the assessment of the fair values. It has been identified that the fair value of the land is $10 million above carrying amount. The valuation should be representative of the amount which market participants would be willing to sell the asset or transfer the liability in an orderly transaction under current market conditions.

The increase in value of $10 million will create an additional taxable temporary difference. In effect, the carrying amount of the land is increased by $10 million with no alteration to the tax base. An additional deferred tax liability arises at the acquisition date of $2 million. Since the deferred tax is an identifiable liability at the acquisition, it should be recognised on acquisition with a corresponding increase in net assets of $8 million ($10m - $2m).

Finished goods should be valued at their estimated sales price less the sum of the costs of disposal and a reasonable profit allowance for the selling effort of the acquiring entity. The fair value of the finished goods is $131 million and so a fair value adjustment of $47 million ($131m - $84m) is required. This creates a further taxable temporary difference in the consolidated financial statements of Chuckle Co with a corresponding deferred tax liability at 20% of $9.4 million.

It is correct that the database as an internally generated intangible asset is not recognised in the individual financial statements of Grin Co. On acquisition, Chuckle Co should recognise the database as a separate intangible asset from goodwill in the consolidated financial statements providing that the database satisfies the criteria for recognition as an intangible asset and a reliable estimate of the fair value can be determined. Although there are no contractual or legal rights associated with the database, the database still appears to be identifiable as it could be sold separately to Grin Co's competitors. The professional expert's valuation of $5 million would appear to provide a reliable estimate of fair value. The database should therefore be recognised in the consolidated financial statements at $5 million with a further increase to the deferred tax liability at 20% equal to $1 million.

Detailed Marking Guide

Item No.	Part	Sub Part	Marking Item (MI)	Marks
	(a)	(i)	Discussion of control (IFRS 10 and other factors) vs. significant influence and application to the scenario	4
		(ii)	Explanation of equity accounting and application to the scenario - Calculation of investment in associate - Adjustment to retained earnings	1 1 1
	(b)		Explanation of the change of classification to that of subsidiary	3
	(c)	(i)	Explanation of the accounting for the additional 18% (step acquisition)	2
		(ii)	Application of the discussion to the scenario of the fair value adjustments required: - Land and DTX - Finished goods and DTX - Database and DTX	2 2 2
		(iii)	Adjustment of spreadsheet for the following: - Equity method to 1 April 20X6 - Remove cost of investment - gain on step acquisition - impact of revaluation to fair value including DTX - goodwill calculation - NCI	1 1 2 4 3 1
Total				30