Answers

(a) Doyle Co

The sale of shares results in Hill Co losing control over Doyle Co. The goodwill, net assets and non-controlling interest (NCI) of Doyle Co must be derecognised from the consolidated statement of financial position. The difference between the proceeds from the disposal (including the fair value of the shares retained) and these amounts will give rise to a $47 million profit on disposal. This is calculated as follows:

	$m	$m
Proceeds		140
Fair value of remaining 40% interest		300
		440
Goodwill at disposal		(50)
Net assets at disposal		(590)
NCI:		
At acquisition	215	
NCI % of post-acquisition profit (40% x ($590m – $510m))	32	
NCI at disposal		247
Profit on disposal		47

After the disposal of shares, Hill Co owns 40% of Doyle Co's shares and has the ability to appoint two of the six members of Doyle Co's board of directors. IAS 28 *Investments in Associates and Joint Ventures* states that an associate is an entity over which an investor has significant influence. Significant influence is presumed when the investor has a shareholding of between 20 and 50%. Representation on the board of directors provides further evidence that significant influence exists.

Therefore, the remaining 40% shareholding in Doyle Co should be accounted for as an associate. It will be initially recognised at its fair value of $300 million and accounted for using the equity method. This means that the group recognises its share of the associate's profit for the year, which equates to $24·6 million ($123m x 6/12 x 40%). As at the reporting date, the associate will be carried at $324·6 million ($300m + $24·6m) in the consolidated statement of financial position.

(c) Deferred tax

According to IAS 12 *Income Taxes*, an entity should recognise a deferred tax asset in respect of the carry-forward of unused tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilised. IAS 12 stresses that the existence of unused losses is strong evidence that future taxable profit may not be available. For this reason, convincing evidence is required about the existence of future taxable profits.

IAS 12 states that entities should consider whether the tax losses result from identifiable causes which are unlikely to recur. Hill Co has now made losses in three consecutive financial years, and therefore significant doubt exists about the likelihood of future profits being generated.

Although Hill Co is forecasting an improvement in its trading performance, this is a result of new products which are currently under development. It will be difficult to reliably forecast the performance of these products. More emphasis should be placed on the performance of existing products and existing customers when assessing the likelihood of future trading profits.

Finally, Hill Co breached a bank loan covenant and some uncertainty exists about its ability to continue as a going concern. This, again, places doubts on the likelihood of future profits and suggests that recognition of a deferred tax asset for unused tax losses would be inappropriate.

Based on the above, it would seem that Hill Co would be incorrect to recognise a deferred tax asset in respect of its unused tax losses.

(d) Convertible bond

Hill Co has issued a compound instrument because the bond has characteristics of both a financial liability (an obligation to repay cash) and equity (an obligation to issue a fixed number of Hill Co's own shares). IAS 32 *Financial Instruments: Presentation* specifies that compound instruments must be split into:

- a liability component (the obligation to repay cash) measured at the present value of the cash repayments, discounted using the market rate on non-convertible bonds; and

- an equity component (the obligation to issue a fixed number of shares) measured as the residual amount (difference cash received and the liability component).

The initial carrying amount of the liability will be measured at $17·9 million, calculated as follows:

Date	**Cash flow $m**	**Discount rate**	**Present value $m**
30 Sep 20X7	0·8	0·909	0·73
30 Sep 20X8	20·8	0·826	17·18
			17·91

The equity component should be initially measured at $2•1 million ($20m – $17•9m).

The equity component will remain unchanged. After initial recognition, the liability will be measured at amortised cost, as follows:

1 October 20X6	**Finance cost (10%)**	**Cash paid ($20m x 4%)**	**30 September 20X7**
$m	**$m**	**$m**	**$m**
17·9	1·8	(0·8)	18·9

The finance cost to be recorded in profit or loss for the year will be $1·8 million

The liability will have a carrying amount of $18·9 million as at the reporting date.

The interest paid of $0.8 million will be a cash outflow presented in the operating activities section of the statement of cash flows.

Marking Guide

Part	Sub Part	Marking Item (MI)	Marks
(a)		Application of the following discussion to the scenario	
		Loss of control	1
		Treatment as associate	2
		Calculations of:	
		Profit on disposal	3
		Treatment as associate	1
(b)		Adjustment for depreciation	1
		Profit on disposal of Doyle Co	1
		Profit on disposal of PPE	1
		Share of profit of associate	1
		Working capital adjustments	3
		Adjustment to purchase of PPE (OFR)	1
		Proceeds on disposal of Doyle Co	1
		Net cash within the subsidiary at disposal	1
		Calculation of PPE cash paid	3
(c)		Application of the following discussion to the scenario:	
		Treatment of deferred tax asset	4
(d)		Application of the following discussion to the scenario:	
		Compound instrument treatment	3
		Calculation of interest and liability	2
		Interest paid to SOCF	1