

Hill Co is the parent company of a group. All entities in the group have a financial year end of 30 September 20X6.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Disposal of Doyle Co - provides information on the acquisition of 60% of Doyle Co on 1 October 20X4 and the subsequent partial disposal of Doyle Co shares on 1 April 20X6.
2. Further information – provides further information about the draft consolidated statement of cash flow (included in pre-formatted response option and exhibit 5).
3. Deferred tax asset - describes circumstances relating to deferred tax assets proposed by Hill Co at 30 September 20X6.
4. Convertible bond issue – provides information about a convertible bond issued on 1 October 20X6.
5. Draft consolidated SOCF – provides extracts of the draft consolidated statement of cash flows (SOCF) for the year ended 30 September 20X6.

This information should be used to answer the question **requirements** within your chosen **response option(s)**.

### **1. Disposal of Doyle Co**

On 1 October 20X4, Hill Co purchased 60% of the ordinary shares of Doyle Co. At this date, the fair value of Doyle Co's identifiable net assets was \$510 million. The non-controlling interest at acquisition was measured at its fair value of \$215 million. Goodwill arising on the acquisition of Doyle Co was \$50 million and had not been impaired prior to the disposal date.

On 1 April 20X6, Hill Co disposed of a 20% holding in the shares of Doyle Co for cash consideration of \$140 million, losing control. At this date, the net assets of Doyle Co, excluding goodwill, were carried in the consolidated financial statements at \$590 million.

From 1 April 20X6, Hill Co has the ability to appoint two of the six members of Doyle Co's board of directors. The fair value of Hill Co's 40% shareholding was \$300 million at that date. Doyle Co reported a profit for the year ended 30 September 20X6 of \$123 million.

## 2. Further information

The group's financial controller has produced draft extracts of the consolidated statement of cash flows and has not yet considered the impact of the disposal of Doyle Co (exhibit 1). There are also some errors. All other consolidated financial statements have been correctly prepared. The draft extracts have been included in the spreadsheet response option.

The carrying amount of the net assets of Doyle Co on 1 April 20X6 were as follows:

	\$m
Property, plant and equipment	311·9
Inventories	200·5
Trade and other receivables	181·3
Cash and cash equivalents	20·9
Trade and other payables	(124·6)
Total	<u>590·0</u>

The statement of cash flows figures for inventories, trade and other receivables, trade and other payables and property, plant and equipment have been calculated by considering only the movement in the balances between the consolidated statement of financial position from 30 September 20X5 to 30 September 20X6.

Hill Co exchanged property, plant and equipment with one of its suppliers on 1 November 20X5. It is estimated that the fair value of both assets exchanged was \$50 million although the carrying amount of the asset transferred by Hill Co was \$45 million at the date of transfer. There were no other disposals of non-current assets by the group during the year other than the disposal of Doyle Co.

The group also acquired property, plant and equipment during the year for cash. The depreciation charge of the group for the year ended 30 September 20X6 was \$775·1 million.

## 3. Deferred tax asset

Hill Co has made a loss in the year ended 30 September 20X6 in its separate financial statements, as well as in the previous two financial years. In the consolidated statement of financial position, it proposes to recognise a deferred tax asset in respect of the carry-forward of unused tax losses. These losses cannot be surrendered to other group companies.

On 30 September 20X6, Hill Co breached a covenant attached to a bank loan which is due for repayment in 20X9. The loan agreement terms state that a

breach in loan covenants entitles the bank to demand immediate repayment of the loan. Hill Co and its subsidiaries do not have sufficient liquid assets to repay the loan in full.

Hill Co has produced a business plan which forecasts significant improvement in its financial situation over the next three years as a result of the launch of new products which are currently being developed.

#### 4. Convertible bond issue

On 1 October 20X6, Hill Co issued a convertible bond at par value of \$20 million. The bond is redeemable for cash on 30 September 20X8 at par. Bondholders can instead opt for conversion in the form of a fixed number of shares in Hill Co. Interest on the bond is payable at a rate of 4% a year in arrears. The interest rate on similar debt without a conversion option is 10%.

##### Discount factors

Year	Discount rate 4%	Discount rate 10%
1	0.952	0.909
2	0.907	0.826

#### 5. Draft consolidated SOCF

The draft extracts have been replicated in the spreadsheet response option.

**Draft extracts from the consolidated statement of cash flows for the Hill group for the year ended 30 September 20X6:**

<b>Cash flows from operating activities:</b>	<b>\$m</b>
Profit before taxation	1,581.7
Adjustments for:	
Increase in inventories	-842.4
Increase in trade and other receivables	-379.2
Increase in trade and other payables	224.2
<b>Cash generated from operations</b>	<b>584.3</b>

Interest paid	-126.8
Income taxes paid	-424.6

<b>Net cash from operating activities</b>	<b>32.9</b>
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**Cash flows from investing activities**

Purchase of property, plant and equipment	-733.8
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<b>Net cash used in investing activities</b>	<b>-733.8</b>
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**Extracts from the consolidated statement of financial position of the Hill group:**

	<b>30 September 20X6</b>	<b>30 September 20X5</b>
	<b>\$m</b>	<b>\$m</b>
Property, plant and equipment	4,953.0	4,219.2

## **Requirements**

**(a) Using exhibit 1, explain, with suitable calculations, how the investment in Doyle Co should be dealt with in the consolidated financial statements for the year ended 30 September 20X6.**

**(7 marks)**

**(b) Using the pre-populated spreadsheet response option and exhibits 1 and 2, update the draft extracts of the consolidated statement of cash flows to adjust for the disposal of Doyle Co shares and to amend for any errors/omissions made by the directors.**

**(13 marks)**

**(c) Using exhibit 3, evaluate the proposed treatment of Hill Co's deferred tax asset.**

**(4 marks)**

**(d) Using exhibit 4, discuss, with suitable calculations, how the convertible bond should be dealt with in the consolidated financial statements for the year ended 30 September 20X7.**

**(6 marks)**

**(30 marks)**