Question 01

(a) The remeasurement component is taken to other comprehensive income and comprises:

- Actuarial gains and losses, such as the return on plan assets which differs from the expected return on the assets included within the net interest figure;
- Changes in the asset ceiling not included within the net interest calculation.

Actuarial gains and losses are sometimes referred to as experience adjustments and arise due to differences between actuarial assumptions and what actually occurred during the period. These will arise in instances such as unexpected movements on interest rates, unexpectedly high or low rates of employee turnover or unexpected increases or decreases in wage growth. The redundancies will create an unusually high level of staff turnover but this should not be treated as part of the remeasurement component. The redundancy will cause the present value of the obligations arising from the defined benefit to decrease. This is classified as a curtailment rather than an experience adjustment to be included within other comprehensive income.

A distinction needs to be made between the basic settlement and the additional pension contribution. The basic settlement is an obligation which Hudson has to pay as compensation for terminating the employee's services regardless of when the employee leaves the entity. IAS 19 *Employee Benefits* requires such payments to be recognised at the earlier of when the plan of termination is announced and when the entity recognises the associated restructuring costs associated with the closure of Wye.

Hudson should therefore have provided in full for the cost of the basic settlement regardless of whether the staff have left or not. This should be recognised as part of the past service cost in the profit or loss of Hudson for the year ended 31 December 20X2.

The additional pension contribution is only paid to employees who complete service up to the closure of division Wye. Since this is expected in early 20X3, these should be accounted for as a short-term benefit. In effect, the contributions are in exchange for the period of service until redundancy. Hudson should estimate the number of employees who will remain with Hudson until the closure of Wye. The cost of this payment should then be spread over the period of service. Since this should be included within the current service cost, this will have an adverse effect on the profit or loss in both 20X2 and 20X3.

In line with the criteria to recognise any provision, as set out in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an 'obligating event' must have arisen for a restructuring provision and for the associated restructuring costs to be recognised. Furthermore, specific conditions must exist for such an obligating event to have arisen in relation to a restructuring provision:

- a detailed formal plan for the restructuring is in place identifying certain criteria required by the accounting standard; and
- a valid expectation has been created in those affected that the restructuring will be carried out, either by starting to implement the plan or publicly announcing its main features.

In the case of Hudson, a valid expectation has been created because the restructuring has been announced, the redundancies have been confirmed and the directors have approved the restructuring in a formal directors meeting. IAS 37 specifically sets out that a provision cannot be made where only a management or board decision to restructure has been taken as it is not considered that this in itself gives rise to an obligation to restructure. IAS 37 also specifies that only the direct expenditure which is necessary as a result of restructuring can be included in the restructuring provision. This includes costs of making employees redundant and costs of terminating certain leases and other contracts directly as a result of restructuring. However, it specifically excludes costs of retraining or relocating staff, marketing or investment in new systems and distribution networks, as these costs relate to future operations and so do not fall under the definition of a provision. Thus the costs of ongoing activities such as relocation activities cannot be provided for.

(b) Deferred taxes represent the amounts of income taxes payable or recoverable in future periods in respect of temporary differences. Temporary differences are differences between the carrying amount of an asset or liability and its tax base. A deferred tax asset arises where the tax base of an asset exceeds the carrying amount. A deferred tax asset can also occur when the tax base of a liability differs from its carrying amount; the eventual settlement of the liability represents a future tax deduction. In relation to unused trading losses, the carrying amount is zero since the losses have not yet been recognised in the financial statements of Hudson. A potential deferred tax asset does arise but the determination of the tax base is more problematic.

The tax base of an asset is the amount which will be deductible against taxable economic benefits from recovering the carrying amount of the asset. Where recovery of an asset will have no tax consequences, the tax base is equal to the carrying amount.

Hudson operates under a tax jurisdiction which only allows losses to be carried forward for two years. The maximum the tax base could be is therefore equal to the amount of unused losses for 20X1 and 20X2 since these only are available to be deducted from future profits. The tax base though needs to be restricted to the extent that there is a probability of sufficient future profits to offset the trading losses.

The directors of Hudson should base their forecast of the future profitability on reasonable and supportable assumptions. There appears to be evidence that this is not the case. Hudson has a recent history of trading losses and there is little evidence that there will be an improvement in trading results within the next couple of years. The market is depressed and sales orders for the first quarter of 20X3 are below levels in any of the previous five years. It is also likely that Hudson will incur various costs in relation to the restructuring which would increase losses into 20X3 and possibly 20X4. Only directly attributable expenses such as redundancies should be included within a provision and expensed in 20X2 which would increase the current year loss. On-going expenses may be incurred such as retraining and relocating costs but these should only be expensed from 20X3. The forecast profitability for 20X3 and subsequent growth rate therefore appear to be unrealistically optimistic. Given that losses can only be carried forward for a maximum of two years, it is unlikely that any deferred tax asset should be recognised.

(c) The directors of Hudson are paid a bonus based upon earnings before interest, tax depreciation and amortisation (EBITDA). It is possible therefore, despite the losses, that once these items are adjusted for the directors may receive a bonus. A self-interest threat will arise. The directors have an incentive to manipulate the financial statements in order to try to minimise the losses and maximise profits. Directors have an ethical responsibility to produce financial statements which are fair, objective and a transparent record of the entity's affairs.

There is evidence that the directors are willing to manipulate the financial statements in a way directly contrary to the ethical principles of integrity and objectivity. It is likely that a net expense should be recognised for the termination payments on the assumption that they would exceed the reduction in present value of the obligation from the curtailment. The directors are wishing to recognise this within other comprehensive income rather than profit or loss despite knowing that it is contrary to international accounting standards. This would improve profitability although it would not impact upon net assets due to a corresponding decrease in equity. The directors also have not recognised a restructuring provision despite the terms being communicated to staff. It is possible that this would be treated as an exceptional cost and therefore would not impact on the bonus. It would therefore be useful to examine the precise terms of the contracts in order to assess the potential impact on the bonus. The treatment does, however, at least in the short term, help Hudson to improve their net assets position.

The deferred tax asset is based upon forecasts for too long a period and is also based on unrealistic assumptions. Earnings before interest, tax, depreciation and amortisation will be overstated as a direct consequence. Net assets will also be overstated, helping Hudson to meet its debt covenant obligations.

The directors' explanation for their proposed treatments are not justified. Directors are appointed to run the business on behalf of the company's shareholders who are the primary stakeholder. It will be in the shareholders' interests for the company to be profitable and to maintain net assets within the debt covenant stipulations. However, this should not be at the expense of the credibility and transparency of the financial statements. Deliberate manipulation of financial statements will reduce stakeholders' confidence in the reliability of the financial statements and the accountancy profession as a whole. The directors are deliberating flouting International Financial Reporting Standards (IFRS® Standards) to improve their bonus and maintain debt covenant obligations.

The directors' actions with regard to the accountant are contrary to the ethical principles of professional behaviour. It appears that the directors have put the accountant under undue pressure to falsify the financial statements to meet their own needs. An intimidation threat arises from the directors' implying that the accountant would lose their job should they not comply with the directors' instructions.

The accountant would also be bound by the ACCA *Code of Ethics* and must adhere to the same ethical principles. They must not therefore comply with the directors' instructions. The accountant should remind the directors of their obligations to comply with the *Code of Ethics*. Should the accountant feel unable to approach the directors directly, they could consider talking to those charged with governance and, in particular, non-executive directors to explain the situation. The accountant could also seek help from the ACCA ethical helpline and take legal advice. Ultimately, if the situation cannot be resolved, the accountant could consider resigning and seeking employment elsewhere.

Question 02

(a) (i) Before assessing whether an entity has joint control over an arrangement, an entity must first assess whether the parties control the arrangement in accordance with the definition of control in IFRS 10 *Consolidated Financial Statements*. If not, an entity must determine whether it has joint control of the arrangement. IFRS 11 *Joint Arrangements* defines joint control as 'the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control'. This means an assessment as to whether any party can prevent any of the other parties from making unilateral decisions without its consent. It must be clear which combination of parties is required to agree unanimously to decisions about the relevant activities of the arrangement. In the case of Kurran, there is more than one combination of parties possible to reach the required majority. As a result, Crypto does not have joint control.

In addition to the above, Crypto does not control Kurran because IFRS 10 states that control requires power over the investee which gives the investor the ability to direct the relevant activities. Crypto does not have the ability to direct the relevant activities as it can only block decisions, and cannot make decisions by itself. Also, there is no shareholder agreement which sets out shareholders' voting rights and obligations and thus the other shareholders can act together to prevent Crypto from making decisions in its own interest. Crypto does not have joint control as agreement between itself and other board members has to occur for a decision to be made. Therefore, it appears that Kurran is an associate of Crypto and would apply IAS 28 *Investments in Associates and Joint Ventures*.

(ii) IFRS 9 *Financial Instruments* states that 'any embedded derivative included in a contract for the sale or purchase of a non-financial item that is denominated in a foreign currency shall be separated when its economic characteristics and risks are not closely related to those of the host contract'. Thus, in contrast to the treatment for hybrid contracts with financial asset hosts, derivatives embedded with a financial liability will often be separately accounted for. That is, they must be separated if they are not closely related to the host contract, they meet the definition of a derivative, and the hybrid contract is not measured at fair value through profit or loss (FVTPL).

The contract is a hybrid contract containing a host contract which is an executory contract to purchase electricity at a price of 20 million euros and a non-closely related embedded foreign currency derivative with an initial fair value of zero to buy 20 million euros, sell 25 million dollars. However, the derivative should have been valued at FVTPL and not fair value through other comprehensive income.

At the date of the modification of the contract to the functional currency of Crypto, there is a significant change to the contract which will trigger a reassessment of its position under IFRS 9. As the contract no longer has a non-closely related embedded derivative, the entire arrangement will be accounted for prospectively as an executory contract which is outside the scope of IFRS 9. The embedded derivative will be derecognised and it is likely that Crypto will have to pay the counterparty 2 million euros in compensation.

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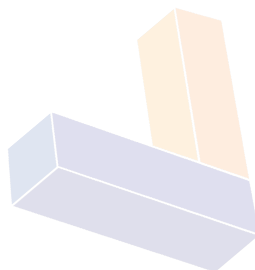

(b)

(a) Definition of corporate governance

Corporate governance is the system by which organisations are configured, co-ordinated and controlled. This usually involves the characteristics of leadership, the structures, particularly at board level, to help facilitate desirable outcomes, and the behaviours of senior management in the pursuit of those outcomes.

Agency relationships underpin any governance situation, in which there is a separation of ownership and control of an organisation. Agency involves two parties: the principal and the agent. In most situations, the agency is the director responsibility for the performance of the organisation and this party reports to the principal in a fiduciary relationship. The principal is the shareholder in the case of a public company but this is less straightforward in public sector organisations, involving taxpayers and a hierarchy of public sector servants who intermediate on behalf of the state and the taxpayer.

Contrast public and private sector corporate governance

In private sector businesses, corporate governance is partly *about delivering acceptable long-term economic returns to investors*. In a public listed company, these shareholders are separated from the agents (directors) and so an agency issue may arise. In a private company, agency problems are less likely to exist.

In pursuit of these returns, corporate governance is also concerned with the *alignment of agency rewards with shareholder priorities*, the *enforcement of professional behaviour* to maximise investor confidence, and the *ethical behaviour* with those entrusted with the management of the company's assets. The value of the company is in part contingent upon the competence of its governance, and the market is capable of punishing behaviour or attitudes it finds unacceptable. This might include non-compliance with regulations or the pursuit of strategies considered sub-optimal or unacceptable to shareholders.

In the public sector, corporate governance is similarly concerned with the configuration and co-ordination of activities but it is usually less likely to be concerned with the delivery of long-term shareholder returns. Because public sector organisations usually deliver public services, the strategic focus of management is likely to be about *balancing the quality and effectiveness of service delivery with cost constraints*.

Because the success of Care Services Company's (CSC) bids for contracts is likely to be based on the commissioning bodies' perceptions of its service delivery quality and the general competence of the organisation, there is likely to be a continuing *concern for the experience of service users and the perceived robustness of its governance structures*. Accordingly, strategic management is primarily concerned not with maximising returns but rather with effective service delivery within the cost constraints imposed by the commissioning bodies. *Gaining and maintaining the full confidence of these bodies and the service users* is thus likely to be the focus of corporate governance in CSC. As the long-term goal for the shareholders of CSC is to sell the company to help fund their retirement, being successful in winning contracts will impact the value of the company. Thus, even with this relatively small, privately-owned company, the public sector governance drivers are key.

(b)

As the non-executive chairman of Care Services Company (CSC), I can testify to the importance of internal controls within the company I help to lead. At the simplest level, *an effective internal control system is necessary to ensure that we can deliver our services on time and within budget*. My own company, CSC, has 165 carers providing important care services. There is a complicated scheduling system and effective internal controls are necessary to ensure that all service users are seen as and when necessary, and that the requisite care is provided during each visit.

In addition, the industry is heavily regulated and internal controls are *necessary to ensure compliance with regulation*. We need to ensure, for example, that all carers are adequately trained, checked for past criminal activity, etc. Compliance is not only necessary for the winning of contracts, but also for the cultivation of public trust in our service provision. You will be aware that care provision companies are subject to the same regulation as other public sector organisations and so internal controls help to ensure compliance with these regulations.

As you will no doubt realise, it is important that the government departments outsourcing these services have confidence in care providers. Our effective internal controls *help to provide a reasonable assurance that care provision companies can and do deliver a quality service* within the cost framework provided. The companies I represent are aware that they are entrusted by taxpayers to provide a high quality service, and our internal controls help to facilitate this.

We also serve our service users and it is vital that these people have full confidence in our reliability and professionalism. Effective internal controls will *enhance the reputation of care services* and increase the trust which commissioning bodies, employees and service users have in our business. Belief in the robustness of our internal controls will mean that service users can rely on our services and trust their carers to serve their needs.

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Question 03 (a)

Evaluation of audit risks

Recognition of 50% equity shareholding in WTC

The 50% equity shareholding is likely to give rise to a joint venture under which control of WTC is shared between ZCG and Wolf Communications Co. IFRS 11 *Joint Arrangements* requires that an investor which has joint control over a joint venture should recognise its investment using the equity method of accounting. Audit risk arises in that despite owning 50% of the equity shares of WTC, ZCG may not actually share control with Wolf Communications, for example, if Wolf Communications retains a right to veto decisions or if ZCG cannot appoint an equal number of board members in order to make joint decisions with board members appointed by Wolf Communications. If ZCG does not have joint control, then WTC should not be treated as a joint venture.

Assuming that there is shared control, an audit risk arises in that ZCG may not have correctly applied equity accounting, thereby potentially over or understating ZCG's investment and resulting in incorrect presentation in the consolidated statement of financial position and statement of profit or loss. The cost of the investment in WTC represents 7·5% of ZCG's total assets at 31 August 2016, thus the investment is material to the Group.

Amortisation of licence to operate in Farland

The licence acquired on 1 January 2015 should be recognised as an intangible asset and amortised on a systematic basis over its useful life. According to IAS 38 *Intangible Assets*, the amortisation method should reflect the pattern of benefits, or if the pattern cannot be determined reliably, the straight-line method of amortisation should be used. Amortisation should begin when the asset is available for use, meaning when it is in the location and condition necessary for it to be capable of operating in the manner which management intends. ZCG therefore should begin to amortise the licence on 1 July 2016 and amortise over the remaining licence period of eight and a half years. The audit risk is that amortisation did not commence at the right point in time or that it has been determined using an inappropriate useful life, leading to over or understatement of the amortisation charge to profit as well as the carrying value of the intangible asset.

Assuming that it is appropriate to use the straight-line method, amortisation for the year to 31 December 2016 should be $3·8 million (65/8·5 x 6/12). This represents 1·3% of extrapolated revenue for the year of $297 million (198 x 12/8) and is therefore material, and the amortisation will be more material next year when a full year's charge to profit is made.

Impairment of the Farland licence

IAS 38 does not require an annual impairment review to be conducted for all intangible assets. However, management should consider whether there are indicators of impairment and if necessary perform an impairment review on the licence. The competitor's actions which appear to have reduced customer demand to a level below that anticipated is an indicator of potential impairment, so management must calculate the recoverable amount of the licence and compare to its carrying value in order to determine if the asset is impaired. Therefore there is a risk that the licence is overstated in value, and operating profit also overstated if any necessary impairment has not been recognised.

Revenue recognition

Revenue recognition is complex and is a significant accounting issue with the risk of error increased by the fact that the Group is implementing the new requirements of IFRS 15 *Revenue from Contracts with Customers* for the first time this year. With the adoption of any new financial reporting standard, there is an audit risk in that the new requirements are unfamiliar to the preparers of the financial statements. There may be errors in the understanding and application of the new rules, especially in areas of judgement, and controls may not have been sufficiently robust over any necessary systems changes. Further, it is surprising that there are no comments in the latest internal audit report on the new controls which should have been implemented during the year in relation to the new requirements of IFRS 15. It is anticipated that internal audit should have been involved in testing the newly implemented controls for effectiveness. This may imply that the controls may not be fit for purpose and again increases control risk and therefore audit risk in this area. We will need to ensure that we document the systems and controls in place and evaluate the significance of any control risk in order that we respond appropriately to any risks of material misstatement which are identified.

The audit team members themselves may be unfamiliar with the new requirements, creating a detection risk. Any necessary changes in accounting policy may not have been appropriately accounted for and disclosed in accordance with IAS 8

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Accounting Policies, Changes in Accounting Estimate and Errors. Given the significance of revenue recognition to the Group's financial statements, the potential misapplication of IFRS 15 and IAS 8 gives rise to a significant audit risk.

ZCG is supplying customers with a multiple-element contract and is providing access to a mobile phone network and a fixed landline and broadband service. The key audit risk arises in relation to whether ZCG accounts for the elements of the contract separately in accordance with IFRS 15 which requires the revenue to be derived from the contract to be allocated to each component. ZCG should have robust systems in place to ensure that contracts can be 'unbundled', enabling the revenue from each part of the contract to be separately determined, otherwise there is a significant risk that the revenue element attributable to each component of the customer contracts will be over or understated.

There is also a risk that the timing of revenue recognition will not be in line with ZCG meeting its performance obligations, also a requirement of IFRS 15. Contracts vary in length, lasting two or three years, and there is an audit risk that the timing of revenue recognition is not appropriate. The fact that total revenue, when extrapolated for the 12-month period, is expected to increase by 35% could indicate that revenue is being recognised too early. This could indicate a misapplication of IFRS 15, possibly changes to accounting policies which have been made on adoption of IFRS 15 are not appropriate.

IFRS 15 contains significant disclosure requirements and there is a risk that ZCG fails to provide sufficient disclosure on a range of matters relevant to its contracts with customers, including the significant judgements made in applying IFRS 15 to those contracts and sufficient disaggregation of the necessary disclosures.

Given the significant volume of individual customer contracts and the complexity of the accounting treatment, revenue recognition is a significant audit risk.

Right to use network capacity

The payment of $17·8 million to acquire access to network capacity represents 3% of total assets and 6% of extrapolated revenue for the year, thus the amount is material. It seems that risk and reward does not pass to ZCG in respect of the assets being used and the seller retains control over the use of its network assets. Therefore the network capacity should not be recognised as an intangible asset of ZCG and the Group is currently adopting an inappropriate accounting treatment which has resulted in intangible assets being overstated. The accounting treatment for these rights should be discussed with ZCG as soon as possible. The most appropriate accounting treatment would seem to be for ZCG to record the cost of the right to use the network capacity as a prepayment and recognise the cost in profit or loss on a straight-line basis over the term of the agreements and this accounting treatment should be reflected in the financial statements as soon as possible. The audit team will need to be made aware of the risk that prepayments and operating expenses are over or understated if the cost has not been treated as a prepayment and/or is not released to profit or loss over an appropriate period.

A further risk is the payment to the network provider is for a specified amount of access to the network provider's network. There is a risk is that ZCG has exceeded the allocated allowance and that any necessary additional payment due for excess usage is not recognised in the financial statements.

Internal controls and fraud risk

The internal audit department has reported that internal controls are 'working well'. This statement will need to be substantiated but gives the impression that control risk is likely to be low. The work of the internal control department will be discussed in more detail in the next section of the briefing notes.

However, it is worth noting that two frauds have been found to be operating during the year, giving rise to audit risk. Although the total monetary amount attributable to the frauds is less than 1% of revenue, therefore immaterial, the fact that the frauds have occurred indicates that there are significant internal control deficiencies which could mean that other frauds are operating. We will need to carefully plan our audit approach to expenses and payroll in light of the increased fraud risk.

The lack of approval and authorisation of expenses discovered by internal audit is concerning as this appears to involve higher level management and may call into question management integrity. We should review the work of internal audit to establish if this is an area where controls have been overridden or if there are current gaps within the control framework. We should review and update our systems notes to identify where reliance can potentially be placed on controls and where there are deficiencies.

The issue uncovered by internal audit in relation to payroll suggests that there is inadequate control over the Group's IT system. Access controls, which form part of the Group's general IT controls, are weak which means that other areas of the system may be vulnerable. This significantly increases control risk and as a result presents a significant area of audit risk. We will need to ensure that we carefully plan our approach as this may mean that there are areas of the system where no reliance can be placed on internal controls and appropriate alternative procedures will need to be applied.

Segmental reporting

Being a listed entity, ZCG should provide segmental information in the notes to the financial statements in accordance with IFRS 8 *Operating Segments*. The audit risk is that the segmental information provided is not sufficiently detailed and/or not based on the information reported internally to the Group's chief operating decision maker. There are some unusual trends in the segmental revenue figures from the management accounts. For example, revenue from south east Asia appears to have increased significantly – if the 2016 revenue figure is extrapolated to a 12-month period, the projected revenue from that segment is $49·5 million, an increase of 65% compared to 2015. There is a risk that revenues have been misallocated between segments and that the disclosure is inaccurate.

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(a) Explanatory note to: Directors of Carbise
Subject: Foreign subsidiary Bikelite

(i) The presentation currency is the currency in which the financial statements are presented. IAS® 21 *The Effects of Changes in Foreign Exchange Rates* permits an entity to present its individual financial statements in any currency. It would therefore be up to the directors of Bikelite to choose a presentation currency for its individual financial statements. Factors which could be considered include the currency used by major shareholders and the currency in which debt finance is primarily raised.

The functional currency is the currency of the primary economic environment in which the entity operates. Since transactions are initially recorded in an entity's functional currency, the results and financial position would need to be retranslated where this differed to the presentation currency.

When determining the presentation and functional currency of Bikelite, consideration should first be given to whether the functional currency of Bikelite should be the same as Carbise, at least whilst under the control of Carbise. It appears that Bikelite has considerable autonomy over its activities. Despite being acquired to make more efficient use of the surplus inventory of Carbise, purchases from Carbise were only 5% of Bikelite's total purchases. Revenue is invoiced in a range of currencies suggesting a geographically diverse range of customers which, although this allows Carbise access to new international markets, is unlikely to be classified as an extension of the parent's operations. The volume of the transactions involved between Carbise and Bikelite would seem to be far too low to come to this conclusion. Bikelite also appears free to retain cash in a range of currencies and is not obliged to remit the cash to Carbise in the form of dividends. Nor does Bikelite appear to be dependent on financing from Carbise with other investors taking up the bond issue at the start of 20X6. The functional currency of Bikelite does not need to be the same as Carbise.

In choosing its functional currency, Bikelite should consider the following primary factors: the currency which mainly influences the sales price for their goods, the currency of the country whose competitive forces and regulations determine the sales price and also the currency which influences labour, material and overhead costs. The key determinant here is the currency which the majority of the transactions are settled in. Bikelite invoices and is invoiced in a large range of currencies and so it would not be immediately clear as to the appropriate functional currency. Nor is there detail about whether there is a currency in which competitive forces and regulations could be important. We do not know, for example, what currency Bikelite's major competitors invoice in.

Secondary factors including the currency in which financing activities are obtained and the currency in which receipts from operating activities are retained can help guide the entity where it is not immediately clear. In relation to Bikelite, a significant volume of their sales are invoiced in dinars and the majority of their expenses too, given that wages and overheads are also paid in dinars. Funds were raised in dinars from the bond issue and so it would appear that the dinar should probably be the functional currency for Bikelite. It is also possible that Bikelite may lose their autonomy on Carbise's sale of their shares which could have implications for the determination of the functional currency.

(ii) Goodwill in dinars on the acquisition of Bikelite would be dinar 42 million calculated as follows:

	Dinars millions
Consideration	100
FV of NCI	22
Less net assets at acquisition (60 + 20)	(80)
Goodwill at acquisition	42

On acquisition, the goodwill in $ would be (dinar 42m/0·5) $84 million.

Goodwill at 30 September 20X6 would be:

	Dinar millions	rate	$ millions
Goodwill at 1 January 20X2	42	0·5	84
Impairment y/e 31 December 20X5	(6)	0·4	(15)
Exchange gain			25·7 (bal)
Goodwill at 31 December 20X5	36	0·38	94·7
Current year exchange gain			8·2 (bal)
Goodwill at 30 September 20X6	36	0·35	102·9

Workings

Dinar impairment of 6 million is translated at the average rate of $1:0·4 dinar = $15 million.

Goodwill at 31 December 20X5 would be translated at last year's closing rate of $1:0·38 dinar = $94·7m.

Goodwill at 31 September 20X6 will be translated at $1:0·35 dinar = $102·9m.

(iii) On a business combination, goodwill is calculated by comparing the fair value of the consideration plus non-controlling interests (NCI) at acquisition with the fair value of the identifiable net assets at acquisition. Carbise measures NCI using the fair value method. This means that goodwill attributable to the NCI is included within the overall calculation of goodwill. An adjustment of dinar 20 million is required to the property of Bikelite to ensure the net assets at acquisition are properly included at their fair value.

At each year end, all assets (and liabilities) are retranslated using the closing rate of exchange. Exchange differences arising on the retranslation are recorded within equity. Since the non-controlling interest is measured under the fair value method, the exchange difference would be apportioned 80%/20% between the owners of Carbise and the non-controlling interest. Only the current year's exchange difference would initially be recorded within other comprehensive income for the year ended 31 December 20X6 whereas cumulative exchange differences on goodwill at 30 September 20X6 would be recorded within equity.

(b) The net assets of Bikelite would have been retranslated each year at the closing rate of exchange. There is therefore an exchange difference arising each year by comparing the opening net assets at the opening rate of exchange with the opening net assets at the closing rate of exchange. An additional exchange difference arises through the profit or loss of Bikelite each year being translated at the average rate of exchange in the consolidated statement of comprehensive income. The profit or loss will increase or decrease the net assets of Bikelite respectively which, as is indicated above, will be translated at the closing rate of exchange within the consolidated statement of financial position. As with goodwill, the exchange differences are included within equity with 80% attributable to the shareholders of Carbise and 20% to the NCI. Cumulative exchange differences will be included within the consolidated statement of financial position with just current year differences recorded within other comprehensive income.

The carrying amount of the net assets of Bikelite on 1 January 20X6 was dinar 48 million. The fair value of their opening net assets therefore would be dinar 64 million (dinar 48 + 16/20 x dinar 20 million). Bikelite would only be consolidated for the first nine months of the year since Carbise loses control on 30 September 20X6. Losses per the individual accounts for the year ended 31 December 20X6 were dinar 8 million, so only dinar 6 million would be consolidated. Additional depreciation of dinar 0·75 million (dinar 20m/20 x 9/12) would be charged for the first nine months of the year. Net assets at disposal in dinars would therefore be dinar 57·25 million (dinar 64 – dinar 6·75). The exchange difference arising in the statement of comprehensive income for the year ended 31 December 20X6 would be $13·4 million calculated as follows:

	$ millions
Opening net assets at opening rate (dinar 64/0·38)	168·4
Loss for 9 months at average rate (dinar 6·75/0·37)	(18·2)
Current year exchange gain (balance)	13·4
Net assets at 30 September 20X6 (dinar 57·25/0·35)	163·6

$10·7 million of the exchange differences are attributed to the shareholders of Carbide (80% x $13·4) and $2·7 million to the NCI.

(c) (i) Group profit or loss on disposal on Bikelite

	$ millions
Proceeds	150
Net assets at disposal (see (b))	(163·6)
Goodwill at disposal (see (a)(ii))	(102·9)
NCI at disposal	48·5
Exchange gains recycled to profit and loss	76·6
Group profit on disposal	8·6

Workings

Exchange gains at 1 January 20X6 per question are $74·1 million. Current year exchange differences on goodwill are $8·2 million (see (b)(i)) and on the net assets are $13·4 million (see (b)). Cumulative exchange gains at 30 September 20X6 are therefore $95·7 million. On disposal, the parent's share (80%) = $76·6 million should be recycled to profit or loss.

NCI at disposal is calculated as follows:

	$ millions
NCI at 1 January 20X6 per question	47·8
NCI share of loss to 30 September 20X6 (20% x dinar 6·75m (see (b))/0·37)	(3·6)
NCI share exchange gains for 9 months to 30 September 20X6 (20% x (13·4 + 8·2))	4·3
NCI at 30 September 20X6	48·5

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(ii) For the year ended 31 December 20X6, Carbise will consolidate Bikelite for the first nine months of the year up to the date of disposal of the shares and subsequent loss of control. NCI will be calculated on the first nine months of losses. Exchange differences on the translation of the net assets, profits and goodwill in relation to the nine months to 30 September 20X6 will initially be recognised in other comprehensive income classified as gains which will be reclassified subsequently to profit or loss.

On 30 September 20X6, a consolidated profit or loss on disposal will be calculated in the consolidated financial statements of Carbise. In effect, the proceeds are compared to the net assets and unimpaired goodwill not attributable to the non-controlling interest at the disposal date. The cumulative exchange differences on the translation of Bikelite would be reclassified to profit or loss.

Consideration should be given as to whether the disposal of Bikelite would constitute a discontinued operation. For Bikelite to be classified as a discontinued operation, it would need to represent a separate major line of business or geographical area of operations. Since Bikelite was initially acquired by Carbise to gain easier access to international markets, it is likely that the criterion would be met.