ACCA Dip IFR

Diploma in International Financial Reporting

Tuesday 9 December 2014

3 (b) Epsilon prepares consolidated financial statements to 30 September each year. On 1 January 2014, Epsilon acquired 75% of the equity shares of Kappa and gained control of Kappa. Kappa has 12 million equity shares in issue. Details of the purchase consideration are as follows:

- On 1 January 2014, Epsilon issued two shares for every three shares acquired in Kappa. On 1 January 2014, the market value of an equity share in Epsilon was $6•50 and the market value of an equity share in Kappa was $6•00.
- On 31 December 2014, Epsilon will make a cash payment of $7•15 million to the former shareholders of Kappa who sold their shares to Epsilon on 1 January 2014. On 1 January 2014, Epsilon would have needed to pay interest at an annual rate of 10% on borrowings.
- On 31 December 2015, Epsilon may make a cash payment of $30 million to the former shareholders of Kappa who sold their shares to Epsilon on 1 January 2014. This payment is contingent upon the revenues of Epsilon growing by 15% over the two-year period from 1 January 2014 to 31 December 2015. On 1 January 2014, the fair value of this contingent consideration was $25 million. On 30 September 2014, the fair value of the contingent consideration was $22 million.

On 1 January 2014, the carrying values of the identifiable net assets of Kappa in the books of that company totalled $60 million. On 1 January 2014, the fair values of these net assets totalled $70 million. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 30 September 2014, Kappa had a poorer than expected operating performance. Therefore on 30 September 2014 it was necessary for Epsilon to recognise an impairment of the goodwill arising on acquisition of Kappa, amounting to 10% of its total computed value.

Required: Compute the impairment of goodwill and explain how this impairment should be recognised in the consolidated financial statements of Epsilon. You should do this under BOTH the methods permitted by IFRS 3 for the initial computation of the non-controlling interest in Kappa at the date of acquisition.