kasneb

CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 24 May 2019. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) A significant number of entities and countries have adopted International Financial Reporting Standards (IFRSs) as their basis for financial reporting. While the advantages of a common set of global reporting standards are recognised, there are a number of implementation challenges at the international and national levels if the objective of an improved and harmonised reporting system is to be achieved.

Required:
Discuss three implementation challenges that are faced by the International Accounting Standards Board (IASB) in its push towards a successful move to IFRSs. (6 marks)

(b) International Financial Reporting Standards (IFRSs) are primarily designed for public limited companies. It has been argued that the same IFRSs should be used by all entities or alternatively, a different body of standards should apply to small and medium-sized entities (SMEs).

Required:
Discuss any two reasons why there is need to develop a set of IFRSs specifically for SMEs. (4 marks)

(c) Sustainability reporting is one of the current reporting requirements for voluntary disclosure which has become the norm for quoted companies.

Required:
Briefly describe three main objectives of sustainability reporting. (6 marks)

(d) With reference to International Public Sector Accounting Standard (IPSAS) 20 "Related Party Disclosures", briefly explain the related party relationships and how related party disclosures under IPSAS 20 differ from those of commercial sector entities under International Accounting Standard (IAS) 24 "Related Party Disclosures". (4 marks)
(Total: 20 marks)

QUESTION TWO

G Limited, a quoted company, operates in the manufacturing sector. It has investments in a number of companies.

The following draft statements of financial position relate to G Limited and its investee companies as at 30 September 2018:

	G Ltd. Sh."million"	S Ltd. Sh."million"	A Ltd. Sh."million"
Assets:			
Non-current assets:			
Property, plant and equipment	4,140	1,350	1,395
Intangible assets	891	540	158
Investments: S Ltd.	3,285		
A Ltd.	900		
	9,216	1,890	1,553
Current assets:			
Inventories	1,102	819	414
Trade receivables	2,016	891	486
Cash and cash equivalents	909	450	190
	4,027	2,160	1,090
Total assets	13,243	4,050	2,643

	Sh."million"	Sh."million"	Sh."million"
Equity and liabilities:			
Ordinary share capital	4,140	1,000	900
Share premium	329	160	90
Retained profits	4,028	1,900	625
	8,497	3,060	1,615
Non-current liabilities:			
8% debentures	1,640	288	333
Deferred tax	1,187	265	243
Current liabilities:			
Trade payables	1,674	319	299
Current tax	245	118	153
Total liabilities	4,746	990	1,028
Total equity and liabilities	13,243	4,050	2,643

Additional information:

1. On 1 October 2015, G Ltd. acquired 80% of the ordinary shares of S Ltd. for a cash consideration of Sh.3,285 million. At the date of acquisition, the retained earnings of S Ltd. stood at Sh.1,650 million and the fair values of the identifiable net assets of S Ltd. approximated their book values except for an item of plant which had a fair value of Sh.175 million in excess of its carrying amount. The plant had a remaining economic useful life of 5 years as at that date.
2. On 1 April 2014, G Ltd. gained joint control over A Ltd. having acquired 50% of its ordinary shares for a cash consideration of Sh.500 million. At that date, the retained earnings of A Ltd. amounted to Sh.225 million. G Ltd. accounted for its share of interest in A Ltd. using the equity method in accordance with IAS 28 (Investments in Associates and Joint Ventures). On 1 April 2018, G Ltd. acquired a further 25% shareholding in A Ltd. for an additional cash consideration of Sh.250 million when the retained earnings of A Ltd. amounted to Sh.525 million. The fair value of the original investment in A Ltd. as at 1 April 2018 was Sh.980 million. No fair value adjustments were necessary in respect of the business combination relating to A Ltd.
3. The group policy is to measure non-controlling interests at fair value. At the respective dates of acquisition, the non-controlling interests in S Ltd. and A Ltd. had fair values of Sh.200 million and Sh.250 million respectively.
4. Goodwill of S Ltd. and A Ltd. was tested for impairment as at 30 September 2018. There was no impairment relating to A Ltd. The recoverable amount of the net assets of S Ltd. was Sh.3,480 million.
5. G Ltd. sold inventory to S Ltd. for Sh.54 million at fair value. G Ltd. reported a loss on the transaction of Sh.9 million and S Ltd. still held half of these goods in inventory at 30 September 2018.
6. On 1 October 2017, G Ltd. acquired patent rights for Sh.45 million to use in a project to develop new products. G Ltd. completed the investigative phase of the project, incurring an additional cost of Sh.32 million and determined that the project was feasible. An effective and working prototype was created at a cost of Sh.18 million and in order to put the products into a saleable condition, a further Sh.14 million was spent. Finally, marketing costs of Sh.9 million were incurred. All of the above costs are included in the intangible assets of G Ltd.

Required:

(a) Determine the amount of goodwill arising on acquisition of S Ltd. and A Ltd. after the impairment review. (6 marks)

(b) Consolidated statement of financial position of G Ltd. group as at 30 September 2018 in accordance with International Financial Reporting Standards (IFRSs). (14 marks)

(Total: 20 marks)

QUESTION THREE

(a) (i) With reference to International Accounting Standard (IAS) 19 "Employee Benefits", briefly explain the accounting treatment of the defined benefit pension surplus (plan asset) in the financial statements of an employer. (4 marks)

(ii) W Limited, a public limited company, operates a defined benefit pension plan for its employees. The present value of the future benefit obligations as at 1 January 2018 was Sh.3,080 million and the fair value of the plan assets as at the same date was Sh.2,860 million.

Further information relating to the pension plan for the year ended 31 December 2018 was as follows:

	Sh."million"
Current service costs	209
Benefits paid to former employees	242
Contributions paid into the plan	259
Present value of benefit obligations as at 31 December 2018	3,360
Fair value of plan assets as at 31 December 2018	3,113

Additional information:

1. Interest cost (gross yield on "blue chip" corporate bonds) is at 5%.
2. On 1 January 2018, the pension plan was amended to provide enhanced benefits with effect from that date. The present value of the enhanced benefits as at 1 January 2018 was calculated by actuaries at Sh.110 million.

Required:
The required notes to the statement of comprehensive income and the statement of financial position to reflect the financial effects of the defined benefit pension plan in the year ended 31 December 2018. (8 marks)

(b) Matatizo Limited has been recording losses for the last few years.

The statement of financial position of the company as at 31 March 2019 was as given below:

	Sh. "000"		Sh. "000"
Equity share capital (Sh.10 par value)	30,000	Goodwill	5,000
10% preference share capital (Sh.100 par value fully paid)	10,000	Plant and machinery	30,000
		Equipment	15,000
Share premium	4,000	Receivables	2,500
Loan from directors	5,000	Inventory	1,500
Bank overdraft	450	Cash in hand	150
Creditors	2,200	Patents and trademarks	500
12% debentures	5,000	Accumulated losses	2,000
	56,650		56,650

The authorised share capital of Matatizo Limited is composed of 5,000,000 equity shares of Sh.10 each and 200,000 10% preference shares of Sh.100 each. It was decided during a meeting of the shareholders and directors of the company to carry out a scheme of internal reconstruction with effect from 1 April 2019 as follows:

1. Each equity share is to be re-designated as a share of Sh.4.50. The equity shareholders are to accept a reduction in the nominal value of their shares from Sh.10 to Sh.4.50. In addition, the shareholders are to subscribe for a new issue of shares on the basis of one share for every 3 held at the price of Sh.6 per share.
2. The existing preference shares are to be exchanged for a new issue of 55,000 15% preference shares of Sh.100 each and 500,000 equity shares of Sh.4.50 each.
3. The 12% debentures are to be converted into 15% debentures. A further Sh.1,000,000 of 15% debentures of Sh.100 each are to be issued at Sh.75 each.
4. The directors agreed to forego 50% of their loan. The balance of the loan is to be settled by the issue of 400,000 equity shares of Sh.4.50 each.
5. The bank overdraft is to be repaid in full.
6. All intangible assets and accumulated losses are to be eliminated.
7. Creditors accepted to be paid half of the amount due at a discount of 10%.
8. Assets are to be adjusted to their fair values by the following amounts:

	Sh. "000"
Plant and machinery	6,100
Equipment	3,250
Receivables	1,160
Inventory	460

9. The share premium account is to be utilised for purposes of capital reduction.

Required:
A capital reduction account for Matatizo Limited after completion of the internal reconstruction. (8 marks)
(Total: 20 marks)

QUESTION FOUR

(a) Briefly explain the various classifications of financial instruments as per IFRS 9 (Financial Instruments). (6 marks)

(b) Tewa Ltd. has provided the following extracts from its income statements for the years ended 31 December 2017 and 31 December 2018:

	Year ended 31 December: 2017 Sh."million"	2018 Sh."million"
Profit before tax (accrues evenly)	950	1,550
Income tax expense	(500)	(900)
Profit after tax	450	650

Capital structure includes:

	Sh."million"	Sh."million"
Ordinary shares of Sh.100 each	2,000	3,300
8% Redeemable preference shares of Sh.100 each	1,000	1,000
10% Convertible preference shares of Sh.100 each	500	500
10% Convertible loan stock	1,500	1,200

Additional information:

1. Part of the increase in the share capital (ordinary) was due to a rights issue that was made on 1 April 2018. A shareholder was granted the right to buy 1 new ordinary share for every 5 ordinary shares held at a price of Sh.120 per share. The market price of the ordinary shares before the rights issue was Sh.125 per share.
2. The convertible loan stock was issued on 1 July 2017. Each Sh.1,000 loan stock is convertible to 25 ordinary shares. Holders of Sh.300 million worth of convertible loan stock exercised their rights on 1 January 2018.
3. The convertible preference shares were issued in the year 2015. One convertible preference share is entitled to one new ordinary share.
4. Meanwhile, on 1 April 2018, the company granted its employees the option to buy 4 million ordinary shares at a strike price of Sh.120 per share. No employee had exercised their right by 31 December 2018. The average market price of the ordinary shares during the year 2018 was Sh.125 per share.
5. The corporation tax rate is 30%.

Required:

(i) The basic earnings per share (EPS) for the years 2017 and 2018. (6 marks)

(ii) The diluted EPS for the years 2017 and 2018. (8 marks)

(Total: 20 marks)

QUESTION FIVE

The consolidated income statement for the year ended 31 March 2019 and the consolidated statements of financial position as at 31 March 2018 and 31 March 2019 of Tembea group were as follows:

Tembea Group
Consolidated income statement for the year ended 31 March 2019

	Sh."000"	Sh."000"
Revenue		74,364
Cost of sales		(56,680)
Gross profit		17,684
Other incomes: Investment income	616	
Gain on disposal of property, plant and equipment	388	1,004
		18,688
Expenses:		
Distributions costs	3,500	
Administrative expenses	5,406	
Finance costs	447	(9,353)
Profit before tax		9,335
Income tax expense		(3,081)
Profit for the year		6,254
Attributable to: Holding company		6,171
Non-controlling interest		83
		6,254

Tembea Group
Consolidated statement of financial position as at 31 March:

	2019 Sh."000"	2018 Sh."000"
Assets:		
Non-current assets:		
Property, plant and equipment	24,062	19,940
Intangible assets	324	540
	24,386	20,480
Current assets:		
Inventory	1,939	1,771
Trade receivables	9,792	9,085
Cash in hand and bank	3,923	3,679
	15,654	14,535
Total assets	40,040	35,015
Capital and liabilities:		
Ordinary share capital	2,479	2,319
Share premium	5,889	5,569
Other reserves	555	555
Retained earnings	7,040	9,379
	15,963	17,822
Non-controlling interest	483	619
Total equity	16,446	18,441

	Sh."000"	Sh."000"
Non-current liabilities:		
Medium term bank loans	3,453	-
Finance lease obligations	476	715
Deferred tax	5,479	3,301
	9,408	4,016
Current liabilities:		
Trade payables	10,608	9,396
Finance lease obligations	141	202
Current tax	2,515	2,357
Bank overdraft	104	-
Interest accrued	54	11
Dividends proposed	764	592
	14,186	12,558
Total equity and liabilities	40,040	35,015

Additional information:

1. Intangible assets represent patents held by the company being amortised over their useful life. No new patents were registered in the year.
2. Property, plant and equipment is made up as follows:

	Land and buildings	Plant and machinery	Total
Cost/valuation	Sh."000"	Sh."000"	Sh."000"
Balance as at 1 April 2018	6,483	22,446	28,929
Subsidiary acquired	1,800	3,378	5,178
Additions	-	5,611	5,611
Disposals	-	(1,092)	(1,092)
Balance as at 31 March 2019	8,283	30,343	38,626
Depreciation:			
Balance as at 1 April 2018	2,582	6,407	8,989
Charge for year	820	2,232	3,052
Subsidiary acquired	1,280	2,023	3,303
Disposals	-	(780)	(780)
Balance as at 31 March 2019	4,682	9,882	14,564

3. Share capital is made up as follows:

	Ordinary share capital Sh."000"	Share premium Sh."000"
As at 1 April 2018	2,319	5,569
Shares issued on acquisition	160	440
Expenses on issue	-	(120)
As at 31 March 2019	2,479	5,889

4. During the year, Tembea group acquired 100% of the shares of Kesi Ltd. The net assets of Kesi Ltd. as at the time of acquisition were as follows:

	Sh."000"
Property, plant and equipment	1,875
Inventory	456
Trade receivables	1,170
Cash at bank and in hand	42
Bank overdraft	(73)
Trade payables	(705)
Medium term bank loans	(967)
Deferred tax	(908)
	890
Consideration:	
Shares allotted	600
Cash	4,400
	5,000

5. During the year, a provision for ordinary dividend amounting to Sh.4.4 million was made from the retained profits.

Required:

Consolidated statement of cash flows in conformity with IAS 7 (Statement of Cash Flows) for the year ended 31 March 2019.

(20 marks)

....