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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

FRIDAY: 27 November 2020. **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 company's financial statements are the most objective way to assess the health of an organisation.

With reference to the above statement:

(i) Identify four primary components of financial statements. (4 marks)

(ii) Examine four warning signs that might identify a financially distressed firm. (8 marks)

(b) Analysts frequently make adjustments to a company's reported financial statements when comparing those statements to those of another company which uses different accounting methods, estimates or assumptions.

In relation to the above statement, discuss four items in the statement of financial positon that might require adjustments for the purpose of comparison. (8 marks)

(Total: 20 marks)

QUESTION TWO

(a) Big Ltd. acquired 80% of the 1 million issued Sh.1 ordinary share capital of Small Ltd. on 1 May 2019 for Sh.1,750,000 when Small Ltd's earnings were Sh.920,000. Small Ltd.'s carrying value of Sh.1,920,000 was considered to be the same as fair value with the exception of the following:

- The carrying value of Small Ltd's property, plant and equipment as at 1 May 2019 was Sh.680,000. The market value at that date was estimated at Sh.745,000. The remaining useful life of the property, plant and equipment was estimated at 5 years from the date of acquisition.
- Small Ltd. had a contingent liability with a fair value of Sh.100,000. There was no change to the value of this liability at the year end.

Additional information:

1. Big Ltd. estimates that the cost of reorganising the combined entity following acquisition will be Sh.200,000.
2. Big Ltd. depreciates all assets on a straight line basis over the estimated useful life on a monthly basis.
3. Small Ltd. sold goods to Big Ltd. with a sales value of Sh.300,000 since the acquisition. All of these goods remain in Big Ltd.'s inventories at the year end. Small Ltd. makes 20% gross profit margin on all sales.
4. The retained earnings reported in the financial statements of Big Ltd. and Small Ltd. as at 31 December 2019 are Sh.3.2 million and Sh.1.1 million respectively. There has been no impairment to goodwill since the date of acquisition.
5. The group policy is to measure non-controlling interest at fair value at the date of acquisition. The fair value of non-controlling interest as at 1 May 2019 was Sh.320,000.

Required:

The amounts that will appear in the consolidated statement of financial position of Big group as at 31 December 2019 for:

(i) Goodwill. (3 marks)
(ii) Consolidated retained earnings. (4 marks)
(iii) Non-controlling interest. (3 marks)

(b) Jared Properties (JP) Ltd., a listed company had 10,000,000 ordinary Sh.1 shares in issue on 1 January 2019.

During the year, the following transactions took place:

1. On 1 April 2019, JP Ltd. made a 1 for 2 bonus share issue.
2. On 1 October 2019, JP Ltd. issued 2,000,000 ordinary Sh.1 shares at their full market price of Sh.7.60 per share. JP Ltd.'s shares were trading at Sh.8.05 per share on 31 December 2019.
3. JP Ltd.'s profit after tax for the year ended 31 December 2019 was Sh.8,200,000.
4. JP Ltd. issued a convertible debt instrument on 1 January 2019. The liability element of the instrument had a value of Sh.6,000,000 on 1 January 2019. The effective interest rate in respect of this liability was 5% per annum.
5. The effective tax rate is 30%.

Required:

(i) Basic earnings per share (BEPS) for the year ended 31 December 2019. (4 marks)

(ii) Diluted earnings per share (DEPS) for the year ended 31 December 2019. (4 marks)

(iii) Explain why bonus issue of shares and issue of shares at full market price are treated differently in the calculation of basic earnings per share. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain four reasons why a company could change its accounting policies. (4 marks)

(b) The following is a summarised financial statement for Rinda Ltd. for the years ended 31 March 2019 and 31 March 2020:

Income statement for the year ended 31 March:

	2020	2019
	Sh."000"	**Sh."000"**
Revenue	1,000,000	720,000
Cost of sales	(800,000)	(600,000)
Gross profit	200,000	120,000
Operating expenses	(104,000)	(88,000)
Finance costs	(32,000)	-
Profit before tax	64,000	32,000
Income tax expense (at 25%)	(16,000)	(8,000)
Profit for the year	48,000	24,000

Statement of financial positions as at 31 March:

	2020	2019
Non-current assets:	**Sh."000"**	**Sh."000"**
Property, plant and equipment	840,000	360,000
Goodwill	40,000	-
	880,000	360,000
Current assets:		
Inventory	100,000	60,000
Trade receivables	52,000	32,000
Bank	-	56,000
	152,000	148,000
Total assets	1,032,000	508,000
Equity and liabilities:		
Equity shares of Sh.1 each	400,000	400,000
Retained earnings	56,000	48,000
	456,000	448,000
Non-current liabilities:		
8% loan notes	400,000	-
Current liabilities:		
Bank overdraft	68,000	-
Trade payables	92,000	52,000
Current tax payable	16,000	8,000
	176,000	60,000
Total equity and liabilities	1,032,000	508,000

Note: Assume a 365-day year.

Required:
Calculate the following ratios for the years ended 31 March 2019 and 31 March 2020:

(i) Return on capital employed. (2 marks)

(ii) Cash ratio (2 marks)

(iii) Net profit margin. (2 marks)

(iv) Current ratio. (2 marks)

(v) Closing inventory holding period. (2 marks)

(vi) Trade receivables collection period. (2 marks)

(vii) Trade payables payment period. (2 marks)

(viii) Gearing (debt/equity). (2 marks)

(Total: 20 marks)

QUESTION FOUR
On 1 July 2019, SM Ltd. acquired 60% of the equity share capital of NY Ltd. through a share exchange of two shares in SM Ltd. for three shares in NY Ltd. This issue of shares had not yet been recorded by SM Ltd.

Below are the summarised draft financial statements for both companies:

Income statements for the year ended 31 December 2019

	SM Ltd.	**NY Ltd.**
	Sh."000"	**Sh."000"**
Revenue	85,000	42,000
Cost of sales	(63,000)	(32,000)
Gross profit	22,000	10,000
Distribution costs	(2,000)	(2,000)
Administrative expenses	(6,000)	(3,200)
Finance costs	(300)	(400)
Profit before tax	13,700	4,400
Income tax expense	(4,700)	(1,400)
Profit for the year	9,000	3,000

Statements of financial position as at 31 December 2019

	SM Ltd.	**NY Ltd.**
	Sh."000"	**Sh."000"**
Assets:		
Non-current assets		
Property, plant and equipment	40,600	12,600
Current assets	16,000	6,600
Total assets	56,600	19,200
Equity and liabilities:		
Equity shares of Sh.1 each	10,000	4,000
Retained earnings	35,400	6,500
	45,400	10,500
Non-current liabilities:		
10% loan notes	3,000	4,000
Current liabilities	8,200	4,700
Total equity and liabilities	56,600	19,200

Additional information:

1. At the date of acquisition, the fair values of NY Ltd.'s assets were equal to their carrying amounts with the exception of an item of plant, which had a fair value of Sh.2 million in excess of its carrying amount. It had a remaining life of five years at that date (straight line depreciation method is used). NY Ltd. has not adjusted the carrying amount of its plant as a result of the fair value exercise.
2. Sales from NY Ltd. to SM Ltd. in the post-acquisition period amount to Sh.8,000,000. NY Ltd. made a mark-up on cost of 40% on these sales.
   SM Ltd. still had goods worth Sh.2,800,000 (at cost) purchased from NY Ltd. in its inventory as at 31 December 2019.
3. NY Ltd.'s trade receivables as at 31 December 2019 include Sh.600,000 due from SM Ltd. which did not agree with SM Ltd.'s corresponding trade payables. Some of this difference was due to cash in transit of Sh.200,000 from SM Ltd. to NY Ltd. Both companies have positive bank balances.
4. SM Ltd. has a policy of accounting for any non-controlling interest at fair value. For this purpose the fair value of the goodwill attributable to the non-controlling interest in NY Ltd. is Sh.1,500,000. Consolidated goodwill was not impaired as at 31 December 2019.
5. Market price of SM Ltd.'s shares on 1 July 2019 was Sh.6 per share.

Required:

(a) The consolidated income statement for SM Ltd. group for the year ended 31 December 2019. (8 marks)

(b) The consolidated statement of financial position for SM Ltd. group as at 31 December 2019. (12 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Good Ltd. issued a Sh.4 million 7% convertible bond on 1 January 2019 par value. The bond is redeemable at par on 31 December 2023 or can be converted at that date on the basis of two Sh.1 ordinary shares for every Sh.10 of bonds held.

The prevailing market rate at 1 January 2019 for a similar bond without conversion rights was 9% per annum. All interest due in the year to 31 December 2019 has been paid.

Required:

Calculate the amounts to be included in the statement of financial position of Good Ltd. in respect of the convertible bond as at 31 December 2019. (5 marks)

(b) JK Ltd. sponsors a defined benefit pension plan for its members of staff. The corporation's actuary provided the following information about the plan:

	1 January 2019	**31 December 2019**
Defined benefit obligation	Sh.2,500,000	Sh.3,000,000
Plan assets (fair value)	Sh.1,700,000	Sh.2,620,000
Discount rate		10%
Benefits paid in 2019		Sh.200,000
Contribution (funding in 2019)		Sh.700,000
Service costs for the year 2019		Sh.400,000
Pension asset/liability	Sh.800,000	?

Required:

(i) The actual return on the plan assets in 2019. (3 marks)

(ii) The amount of other comprehensive income as of 31 December 2019. (Assume the 1 January 2019 balance was zero). (8 marks)

(iii) Distinguish between "past service costs" and "service costs" in relation to IAS 19 "Employee benefits". (4 marks)

(Total: 20 marks)

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Present Value Interest factor of 1 Received at the End of *n* Periods at r Percent:

$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	20%	24%	25%	30%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8333	0.8065	0.8000	0.7692
2	0.9803	0.9612	0.9426	0.9246	0.9070	0.8900	0.8734	0.8573	0.8417	0.8264	0.8116	0.7972	0.7831	0.7695	0.7561	0.7432	0.6944	0.6504	0.6400	0.5917
3	0.9706	0.9423	0.9151	0.8890	0.8638	0.8396	0.8163	0.7938	0.7722	0.7513	0.7312	0.7118	0.6931	0.6750	0.6575	0.6407	0.5787	0.5245	0.5120	0.4552
4	0.9610	0.9238	0.8885	0.8548	0.8227	0.7921	0.7629	0.7350	0.7084	0.6830	0.6587	0.6355	0.6133	0.5921	0.5718	0.5523	0.4823	0.4230	0.4096	0.3501
5	0.9515	0.9057	0.8626	0.8219	0.7835	0.7473	0.7130	0.6806	0.6499	0.6209	0.5935	0.5674	0.5428	0.5194	0.4972	0.4761	0.4019	0.3411	0.3277	0.2693
6	0.9420	0.8880	0.8375	0.7903	0.7462	0.7050	0.6663	0.6302	0.5963	0.5645	0.5346	0.5066	0.4803	0.4556	0.4323	0.4104	0.3349	0.2751	0.2621	0.2072
7	0.9327	0.8706	0.8131	0.7599	0.7107	0.6651	0.6227	0.5835	0.5470	0.5132	0.4817	0.4523	0.4251	0.3996	0.3759	0.3538	0.2791	0.2218	0.2097	0.1594
8	0.9235	0.8535	0.7894	0.7307	0.6768	0.6274	0.5820	0.5403	0.5019	0.4665	0.4339	0.4039	0.3762	0.3506	0.3269	0.3050	0.2326	0.1789	0.1678	0.1226
9	0.9143	0.8368	0.7664	0.7026	0.6446	0.5919	0.5439	0.5002	0.4604	0.4241	0.3909	0.3606	0.3329	0.3075	0.2843	0.2630	0.1938	0.1443	0.1342	0.0943
10	0.9053	0.8203	0.7441	0.6756	0.6139	0.5584	0.5083	0.4632	0.4224	0.3855	0.3522	0.3220	0.2946	0.2697	0.2472	0.2267	0.1615	0.1164	0.1074	0.0725
11	0.8963	0.8043	0.7224	0.6496	0.5847	0.5268	0.4751	0.4289	0.3875	0.3505	0.3173	0.2875	0.2607	0.2366	0.2149	0.1954	0.1346	0.0938	0.0859	0.0558
12	0.8874	0.7885	0.7014	0.6246	0.5568	0.4970	0.4440	0.3971	0.3555	0.3186	0.2858	0.2567	0.2307	0.2076	0.1869	0.1685	0.1122	0.0757	0.0687	0.0429
13	0.8787	0.7730	0.6810	0.6006	0.5303	0.4688	0.4150	0.3677	0.3262	0.2897	0.2575	0.2292	0.2042	0.1821	0.1625	0.1452	0.0935	0.0610	0.0550	0.0330
14	0.8700	0.7579	0.6611	0.5775	0.5051	0.4423	0.3878	0.3405	0.2992	0.2633	0.2320	0.2046	0.1807	0.1597	0.1413	0.1252	0.0779	0.0492	0.0440	0.0254
15	0.8613	0.7430	0.6419	0.5553	0.4810	0.4173	0.3624	0.3152	0.2745	0.2394	0.2090	0.1827	0.1599	0.1401	0.1229	0.1079	0.0649	0.0397	0.0352	0.0195
16	0.8528	0.7284	0.6232	0.5339	0.4581	0.3936	0.3387	0.2919	0.2519	0.2176	0.1883	0.1631	0.1415	0.1229	0.1069	0.0930	0.0541	0.0320	0.0281	0.0150
17	0.8444	0.7142	0.6050	0.5134	0.4363	0.3714	0.3166	0.2703	0.2311	0.1978	0.1696	0.1456	0.1252	0.1078	0.0929	0.0802	0.0451	0.0258	0.0225	0.0116
18	0.8360	0.7002	0.5874	0.4936	0.4155	0.3503	0.2959	0.2502	0.2120	0.1799	0.1528	0.1300	0.1108	0.0946	0.0808	0.0691	0.0376	0.0208	0.0180	0.0089
19	0.8277	0.6864	0.5703	0.4746	0.3957	0.3305	0.2765	0.2317	0.1945	0.1635	0.1377	0.1161	0.0981	0.0829	0.0703	0.0596	0.0313	0.0168	0.0144	0.0068
20	0.8195	0.6730	0.5537	0.4564	0.3769	0.3118	0.2584	0.2145	0.1784	0.1486	0.1240	0.1037	0.0868	0.0728	0.0611	0.0514	0.0261	0.0135	0.0115	0.0053
21	0.8114	0.6598	0.5375	0.4388	0.3589	0.2942	0.2415	0.1987	0.1637	0.1351	0.1117	0.0926	0.0768	0.0638	0.0531	0.0443	0.0217	0.0109	0.0092	0.0040
22	0.8034	0.6468	0.5219	0.4220	0.3418	0.2775	0.2257	0.1839	0.1502	0.1228	0.1007	0.0826	0.0680	0.0560	0.0462	0.0382	0.0181	0.0088	0.0074	0.0031
23	0.7954	0.6342	0.5067	0.4057	0.3256	0.2618	0.2109	0.1703	0.1378	0.1117	0.0907	0.0738	0.0601	0.0491	0.0402	0.0329	0.0151	0.0071	0.0059	0.0024
24	0.7876	0.6217	0.4919	0.3901	0.3101	0.2470	0.1971	0.1577	0.1264	0.1015	0.0817	0.0659	0.0532	0.0431	0.0349	0.0284	0.0126	0.0057	0.0047	0.0018
25	0.7798	0.6095	0.4776	0.3751	0.2953	0.2330	0.1842	0.1460	0.1160	0.0923	0.0736	0.0588	0.0471	0.0378	0.0304	0.0245	0.0105	0.0046	0.0038	0.0014
30	0.7419	0.5521	0.4120	0.3083	0.2314	0.1741	0.1314	0.0994	0.0754	0.0573	0.0437	0.0334	0.0256	0.0196	0.0151	0.0116	0.0042	0.0016	0.0012	*
35	0.7059	0.5000	0.3554	0.2534	0.1813	0.1301	0.0937	0.0676	0.0490	0.0356	0.0259	0.0189	0.0139	0.0102	0.0075	0.0055	0.0017	0.0005	*	*
36	0.6989	0.4902	0.3450	0.2437	0.1727	0.1227	0.0875	0.0626	0.0449	0.0323	0.0234	0.0169	0.0123	0.0089	0.0065	0.0048	0.0014	*	*	*
40	0.6717	0.4529	0.3066	0.2083	0.1420	0.0972	0.0668	0.0460	0.0318	0.0221	0.0154	0.0107	0.0075	0.0053	0.0037	0.0026	0.0007	*	*	*
50	0.6080	0.3715	0.2281	0.1407	0.0872	0.0543	0.0339	0.0213	0.0134	0.0085	0.0054	0.0035	0.0022	0.0014	0.0009	0.0006	*	*	*	*

Present Value Interest factors for Annuity of 1 Discounted at r Percent for *n* Periods:

$PVIFA_{r,n} = [1 - 1/(1+r)^n]/r$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	20%	24%	25%	30%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8333	0.8065	0.8000	0.7692
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.7125	1.6901	1.6681	1.6467	1.6257	1.6052	1.5278	1.4568	1.4400	1.3609
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4437	2.4018	2.3612	2.3216	2.2832	2.2459	2.1065	1.9813	1.9520	1.8161
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.1024	3.0373	2.9745	2.9137	2.8550	2.7982	2.5887	2.4043	2.3616	2.1662
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6959	3.6048	3.5172	3.4331	3.3522	3.2743	2.9906	2.7454	2.6893	2.4356
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.2305	4.1114	3.9975	3.8887	3.7845	3.6847	3.3255	3.0205	2.9514	2.6427
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.7122	4.5638	4.4226	4.2883	4.1604	4.0386	3.6046	3.2423	3.1611	2.8021
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	5.1461	4.9676	4.7988	4.6389	4.4873	4.3436	3.8372	3.4212	3.3289	2.9247
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.5370	5.3282	5.1317	4.9464	4.7716	4.6065	4.0310	3.5655	3.4631	3.0190
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.8892	5.6502	5.4262	5.2161	5.0188	4.8332	4.1925	3.6819	3.5705	3.0915
11	10.368	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	6.2065	5.9377	5.6869	5.4527	5.2337	5.0286	4.3271	3.7757	3.6564	3.1473
12	11.255	10.575	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.4924	6.1944	5.9176	5.6603	5.4206	5.1971	4.4392	3.8514	3.7251	3.1903
13	12.134	11.348	10.635	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.7499	6.4235	6.1218	5.8424	5.5831	5.3423	4.5327	3.9124	3.7801	3.2233
14	13.004	12.106	11.296	10.563	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.9819	6.6282	6.3025	6.0021	5.7245	5.4675	4.6106	3.9616	3.8241	3.2487
15	13.865	12.849	11.938	11.118	10.380	9.7122	9.1079	8.5595	8.0607	7.6061	7.1909	6.8109	6.4624	6.1422	5.8474	5.5755	4.6755	4.0013	3.8593	3.2682
16	14.718	13.578	12.561	11.652	10.838	10.106	9.4466	8.8514	8.3126	7.8237	7.3792	6.9740	6.6039	6.2651	5.9542	5.6685	4.7296	4.0333	3.8874	3.2832
17	15.562	14.292	13.166	12.166	11.274	10.477	9.7632	9.1216	8.5436	8.0216	7.5488	7.1196	6.7291	6.3729	6.0472	5.7487	4.7746	4.0591	3.9099	3.2948
18	16.398	14.992	13.754	12.659	11.690	10.828	10.059	9.3719	8.7556	8.2014	7.7016	7.2497	6.8399	6.4674	6.1280	5.8178	4.8122	4.0799	3.9279	3.3037
19	17.226	15.678	14.324	13.134	12.085	11.158	10.336	9.6036	8.9501	8.3649	7.8393	7.3658	6.9380	6.5504	6.1982	5.8775	4.8435	4.0967	3.9424	3.3105
20	18.046	16.351	14.877	13.590	12.462	11.470	10.594	9.8181	9.1285	8.5136	7.9633	7.4694	7.0248	6.6231	6.2593	5.9288	4.8696	4.1103	3.9539	3.3158
21	18.857	17.011	15.415	14.029	12.821	11.764	10.836	10.017	9.2922	8.6487	8.0751	7.5620	7.1016	6.6870	6.3125	5.9731	4.8913	4.1212	3.9631	3.3198
22	19.660	17.658	15.937	14.451	13.163	12.042	11.061	10.201	9.4424	8.7715	8.1757	7.6446	7.1695	6.7429	6.3587	6.0113	4.9094	4.1300	3.9705	3.3230
23	20.456	18.292	16.444	14.857	13.489	12.303	11.272	10.371	9.5802	8.8832	8.2664	7.7184	7.2297	6.7921	6.3988	6.0442	4.9245	4.1371	3.9764	3.3254
24	21.243	18.914	16.936	15.247	13.799	12.550	11.469	10.529	9.7066	8.9847	8.3481	7.7843	7.2829	6.8351	6.4338	6.0726	4.9371	4.1428	3.9811	3.3272
25	22.023	19.523	17.413	15.622	14.094	12.783	11.654	10.675	9.8226	9.0770	8.4217	7.8431	7.3300	6.8729	6.4641	6.0971	4.9476	4.1474	3.9849	3.3286
30	25.808	22.396	19.600	17.292	15.372	13.765	12.409	11.258	10.274	9.4269	8.6938	8.0552	7.4957	7.0027	6.5660	6.1772	4.9789	4.1601	3.9950	3.3321
35	29.409	24.999	21.487	18.665	16.374	14.498	12.948	11.655	10.567	9.6442	8.8552	8.1755	7.5856	7.0700	6.6166	6.2153	4.9915	4.1644	3.9984	3.3330
36	30.108	25.489	21.832	18.908	16.547	14.621	13.035	11.717	10.612	9.6765	8.8786	8.1924	7.5979	7.0790	6.6231	6.2201	4.9929	4.1649	3.9987	3.3331
40	32.835	27.355	23.115	19.793	17.159	15.046	13.332	11.925	10.757	9.7791	8.9511	8.2438	7.6344	7.1050	6.6418	6.2335	4.9966	4.1659	3.9995	3.3332
50	39.196	31.424	25.730	21.482	18.256	15.762	13.801	12.233	10.962	9.9148	9.0417	8.3045	7.6752	7.1327	6.6605	6.2463	4.9995	4.1666	3.9999	3.3333

kasneb

CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

WEDNESDAY: 27 November 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) The International Accounting Standards Board's (IASB) framework for the preparation and presentation of financial statements requires financial statements to be prepared on the basis of certain accounting concepts and assumptions:

Required:
Explain the following concepts and assumptions:

(i) Accruals concept. (1 mark)

(ii) Substance over form. (1 mark)

(iii) Prudence. (1 mark)

(iv) Comparability. (1 mark)

(v) Materiality. (1 mark)

(b) The following financial statements were extracted from the books of Ujenzi Ltd.:

Statement of comprehensive income for the year ended 30 June 2019:

	Sh. "000"
Revenue	8,600
Cost of sales	(4,000)
Gross profit	4,600
Operating expenses	(2,000)
Finance costs	(500)
Profit before tax	2,100
Income tax expenses	(900)
Profit after tax	1,200
Dividend paid in the year	600
Retained earnings	600

Statement of financial position as at 30 June:

	2019		**2018**	
	Sh. "000"	**Sh. "000"**	**Sh. "000"**	**Sh. "000"**
Non-current assets:				
Property, plant and equipment		8,400		7,400
Current assets:				
Inventory	3,000		3,200	
Trade receivables	4,400	7,400	3,600	6,800
Total assets		15,800		14,200

	2019		2018	
	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"
Equity and liabilities:				
Equity				
Ordinary share capital		2,400		2,400
Retained earnings		4,400		3,800
		6,800		6,200
Non-current liabilities:				
Deferred tax	2,140		1,700	
Finance lease liabilities	2,600	4,740	2,400	4,100
Current liabilities:				
Trade payables	2,500		2,180	
Current tax	450		410	
Finance lease liabilities	1,000		900	
Bank overdrafts	310	4,260	410	3,900
		15,800		14,200

Additional information:

1. Depreciation charged for the year ended 30 June 2019 amounted to Sh.1,940,000.
2. During the year ended 30 June 2019, there was no disposal of property, plant or equipment.
3. There was no accrual of interest at the beginning or at the end of the year.
4. Ujenzi Ltd. finances some of its property, plant and equipment using finance leases. During the year ended 30 June 2019, property, plant and equipment which could have cost Sh.1,200,000 to purchase were acquired under finance lease.

Required:

(i) Statement of cash flows in accordance with the requirements of the International Accounting Standard (IAS) 7, "Statement of Cash Flows". (10 marks)

(ii) Summarise five advantages of cash flow statements to the users of financial statements. (5 marks)

(Total: 20 marks)

QUESTION TWO

(a) Financial statements analysis might be a useful tool for understanding a firm's performance.

In relation to the above statement, discuss five challenges that a financial analyst might face while analysing financial statements. (10 marks)

(b) The following information relates to Red Ltd. for the year ended 30 June 2019:

	Sh.
Long-term debt:	
10% notes payable	1,000,000
8% convertible bonds payable	5,000,000
10% bonds payable	6,000,000
Total long-term debt	12,000,000
Shareholders equity:	
6% cumulative preference shares (Sh.50 par value): 100,000 shares authorised, 25,000 shares issued and outstanding	1,250,000
Ordinary shares (Sh.1 par value): 10,000,000 shares authorised 1,000,000 shares issued and outstanding	1,000,000
Additional paid in capital	4,000,000
Retained earnings	6,000,000
Total shareholders equity	12,250,000

Additional information:

1. Options were granted on 1 July 2018 to purchase 200,000 shares at Sh.15 per share. Although no options were exercised during the year ended 30 June 2019, the average price per ordinary share was Sh.20.
2. Each bond was issued at face value. The 8% convertible bonds will convert into ordinary shares at 50 shares per Sh.1,000 bonds. The bonds are exercisable after 5 years and were issued in the year ended 30 June 2018.
3. The preference shares were issued during the year ended 30 June 2018.
4. There are no preference share dividends in arrears. However, preference share dividends were not declared in the year ended 30 June 2019.
5. The 1,000,000 ordinary shares were outstanding for the entire year ended 30 June 2019.
6. Net income for the year ended 30 June 2019 was Sh.1,500,000 and the average income tax rate is 30%.

Required:

(i) Basic earnings per share (BEPS) for the year ended 30 June 2019. (3 marks)

(ii) Diluted earnings per share (DEPS) for the year ended 30 June 2019. (7 marks)

(Total: 20 marks)

QUESTION THREE

Bidii Ltd. has identified Sweet Ltd. as a possible acquisition. Sweet Ltd. is currently owned by Yummy Ltd.

The following are extracts from the financial statements of Sweet Ltd.

Extract from the income statement for the year ended 31 December 2018:

	Sh."000"
Revenue	54,200
Cost of sales	(21,500)
Gross profit	32,700
Operating expenses	(11,700)
Operating profit	21,000

Statement of financial position as at 31 December 2018:

	Sh."000"	Sh."000"
Assets		
Non-current assets		24,400
Current assets:		
Inventory	4,900	
Receivables	5,700	
Cash at bank	2,300	12,900
Total assets		37,300
Equity and liabilities:		
Equity		
Equity shares		1,000
Retained earnings		8,000
		9,000
Liabilities		
Non-current liability		
Loan		16,700
Current liabilities:		
Trade payables	5,400	
Current tax payables	6,200	11,600
Total equity and liabilities		37,300

Additional information:

1. On 1 April 2018, Sweet Ltd. decided to focus on its core business and so disposed of a non-core division. The disposal generated a loss of Sh.1.5 million which included operating expenses.

   The following extracts show the results of the non-core division for the period prior to disposal which were included in Sweet Ltd.'s results for 2018:

	Sh. "000"
Revenue	2,100
Cost of sales	(1,200)
Gross profit	900
Operating expenses	(700)
Operating profit	200

2. Sweet Ltd. pays a management charge of 1% of revenue to Yummy Ltd. which is included in its operating expenses. Bidii Ltd. imposes a management charge of 10% of gross profit on all of its subsidiaries.
3. Sweet Ltd.'s administrative offices are currently located within a building owned by Yummy Ltd. If Sweet Ltd. were acquired, the company would need to seek alternative premises. Sweet Ltd. paid rent of Sh.46,000 in 2018. Commercial rent for equivalent office space would cost Sh.120,000.

Required:

(a) Sweet Ltd.'s income statement for the year ended 31 December 2018 to adjust for the disposal of the non-core division, management charge and rent charges which would be imposed assuming Sweet Ltd. was acquired by Bidii Ltd. (5 marks)

(b) Calculate the following ratios for the year ended 31 December 2018 based on the restated financial information in (a) above:

Note: You should assume that any increase or decrease in profit as a result of your adjustment will also increase or decrease cash:

(i) Gross profit margin. (1 mark)

(ii) Operating profit margin. (1 mark)

(iii) Receivables collection period. (1 mark)

(iv) Acid-test ratio. (1 mark)

(v) Gearing (debt/equity) (1 mark)

(c) The following information relates to Kikombe Ltd:

Year	**2014**	**2015**	**2016**	**2017**	**2018**
Profit margin (%)	11.4	12.3	13.5	15.5	16.7
Retention ratio (%)	91.3	91.9	92.8	92.2	86.6
Asset turnover	1.25	1.14	1.11	1.00	0.97
Assets (Sh.)	2,436	3,118	3,861	4,923	5,483
Equity (Sh.)	1,406	1,756	2,233	2,958	3,219
Growth rate in sales (%)	17.8	16.4	21.4	14.0	8.5

Required:

(i) The firm's annual sustainable growth rate from year 2014 to year 2018. (4 marks)

(ii) Explain how the firm copes with its sustainable growth problems. (1 mark)

(d) Bahari Equipments Ltd. sells high quality lawn mowers and offers a three year warranty on all new lawn mowers sold. During the year 2018, the firm sold new speciality mowers for Sh.300,000.

Bahari's service department does not have the equipment to service the new lawn mowers and therefore has entered into an agreement with Top Mower Ltd. to provide all warranty service on the special mowers sold in the year 2018.

Bahari Equipments Ltd. wishes to measure the fair value of the agreement in order to determine the warranty liability for sales made during the year 2018.

The financial analyst for Bahari Equipments Ltd. estimates the following expected warranty cash flows associated with the mowers sold during the year 2018:

Year	Cash flow estimate (Sh.)	Probability assessment (%)
2019	2,500	20
	4,000	60
	5,000	20
2020	3,000	30
	5,000	50
	6,000	20
2021	4,000	30
	6,000	40
	7,000	30

All cash flows occur at the end of the year. The annual discount rate is 5%.

Required:
The value of the warranty liability for year 2018 sales. (5 marks)
(Total: 20 marks)

QUESTION FOUR

(a) Preparations of group accounts is considered necessary. However, group accounts might be misleading.

With reference to the above statement, outline three limitations of group accounts. (3 marks)

(b) The statements of financial position for JDR Ltd. and BZ Ltd. as at 30 June 2019 are provided below:

	JDR Ltd. Sh."000"	BZ Ltd. Sh."000"
Assets		
Non-current assets:		
Property, plant and equipment	80,650	17,000
Available for sale investment	14,350	-
	95,000	17,000
Current assets:		
Inventory	18,000	4,000
Receivables	30,000	9,500
Cash and cash equivalents	6,000	1,500
Total assets	149,000	32,000
Equity and liabilities:		
Equity		
Share capital (Sh.1 equity shares)	50,000	5,000
Retained earnings	68,000	13,000
Other reserves	800	-
Total equity	118,800	18,000
Non-current liabilities	10,000	4,000
Current liabilities	20,200	10,000
Total equity and liabilities	149,000	32,000

Additional information:

1. JDR Ltd. acquired a 20% investment in BZ Ltd. on 1 February 2015 for Sh.3,200,000. The investment was classified as available for sale with any associated gains or losses recorded within other reserves in JDR Ltd.'s individual financial statements.
2. On 1 January 2019, JDR Ltd. acquired an additional 60% of the equity share capital of BZ Ltd. at a cost of Sh.10,350,000 when the retained earnings of BZ Ltd. were Sh.10,500,000.
3. The fair value of the original 20% investment at 1 January 2019 was Sh.3,950,000. In its own financial statements, JDR Ltd. continues to hold the investment in BZ Ltd. as an available for sale asset and it is recorded at its fair value of Sh.14,350,000 as at 30 June 2019.
4. As at 1 January 2019, the fair value of the net assets of BZ Ltd. was assessed to be the same as its carrying value with one exception, property, plant and equipment (PPE).
5. Leasehold property with a carrying value of Sh.6,400,000 had a fair value of Sh.8,000,000. The remaining useful life of this asset is 10 years from the date of acquisition.
6. Depreciation on property, plant and equipment is charged on a monthly straight line basis. The fair value of plant and equipment was declared to be equivalent to its carrying value at the date of acquisition.
7. It is the group policy to value non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interest at 1 January 2019 was Sh.3,700,000.
8. BZ Ltd. receivables as at 30 June 2019 included Sh.3,000,000 in respect of goods sold by BZ Ltd. to JDR Ltd. in April 2019. JDR Ltd.'s inventories as at 30 June 2019 included Sh.1,000,000 of these goods and closing payables included an amount due to BZ Ltd. of Sh.1,000,000.
9. JDR Ltd. made a payment of Sh.2,000,000 to BZ Ltd. on 30 June 2019.
10. BZ Ltd. makes a margin of 20% on all sales.

Required:

The consolidated statement of financial position as at 30 June 2019 for the JDR Ltd. group. (17 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Accounting for retirement benefits remains one of the most challenging areas in financial statements analysis.

With reference to the above statement, discuss four key issues in the determination of the method of accounting for retirement benefits in respect of defined benefit plans. (8 marks)

(b) Ndoto Ltd. provides post-employment benefits to its employees through a defined benefit plan.

The following data relates to the plan as at 30 June:

	2019 Sh."000"	2018 Sh."000"
Present value of obligation at year end	72,000	66,000
Fair value of plan assets at year end	62,000	60,000
Current service cost	12,000	11,400
Benefits paid by plan	16,000	15,000
Contribution paid into plan	11,600	11,200
Discount rate at the start of the year	10%	9%
Expected rate of return on plan assets at the start of the year	7%	6%
Average remaining service life of participating employees	20 years	20 years

Additional information:

1. On 1 July 2018, Ndoto Ltd. had net unrecognised actuarial losses of Sh.8.4 million.
2. Ndoto Ltd. accounts for actuarial gains and losses using the corridor method.

Required:

(i) Extract of income statement for the year ended 30 June 2019. (3 marks)

(ii) Extract of the statement of financial position as at 30 June 2019. (3 marks)

(iii) The changes in the present value of the defined benefit obligation. (3 marks)

(iv) The changes in the fair value of the plan assets. (3 marks)

(Total: 20 marks)

....

Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8065	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	.5739	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	.5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	.3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	.1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	.0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5674	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	.1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	.0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0318	.0221	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1-\frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 23 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) Describe the steps followed by financial analysts while undertaking a financial statements analysis assignment. (4 marks)

(b) (i) Explain the term "macro environment approach" to financial statements analysis. (1 mark)

(ii) Citing relevant examples, outline three factors that forms the basis of macro-economic environment of a firm. (3 marks)

(c) Pipel Limited, a public listed company carries out business in airline technology. It has made several investments, operating in diversified businesses. The following statements of comprehensive income relate to Pipel Limited and its investment companies for the year ended 30 April 2019:

	Pipel Limited Sh."million"	Sial Limited Sh."million"	Abbel Limited Sh."million"
Revenue	2,060	590	360
Cost of sales	(1,050)	(220)	(270)
Gross profit	1,010	370	90
Selling and distribution costs	(245)	(77)	(68)
Administrative expenses	(315)	(99)	(112)
Operating profits (or loss)	450	194	(90)
Finance costs	(140)	(44)	-
Profit (or loss) before tax	310	150	(90)
Income tax expense (credit)	(75)	(50)	10
Profit (or loss) for the year	235	100	(80)
Other comprehensive income – Revaluation gain	50	25	10
Total comprehensive income	285	125	(70)

Additional information:

1. Pipel Limited has owned 80% of the equity interest in Sial Limited for several years.
2. On 1 May 2014, Pipel Limited acquired 60% of the equity shares of Abbel Limited. The purchase consideration comprised cash of Sh.645 million and the fair value of the identifiable net assets acquired was Sh.775 million at that date.
3. Pipel Limited wishes to use the "partial goodwill" method for all acquisitions. There has been no impairment of goodwill in either Sial Limited or Abbel Limited since acquisition.
4. Pipel Limited disposed of a 20% equity interest in Abbel Limited on 31 October 2018 for Sh.280 million. At that date, Abbel Limited's identifiable net assets were Sh.955 million. The remaining equity interest in Abbel Limited was fair valued at Sh.560 million.
5. During the year ended 30 April 2019, Sial Limited sold goods worth Sh.60 million to Pipel Limited. Sial Limited makes all sales at a profit mark-up of $33^1/_3$% above the cost. Pipel Limited still had one third of these goods in its inventory on 30 April 2019.
6. Assume profit (or loss) and revaluation gain accrued evenly over the year.

Required:

(i) The profit or loss on disposal of shares in Abbel Limited to be presented on the group statement of comprehensive income. (4 marks)

(ii) Consolidated statement of comprehensive income for Pipel Group for the year ended 30 April 2019. (8 marks)

(Total: 20 marks)

QUESTION TWO

(a) Financial statements are highly aggregated which could make them of limited use for stakeholders who want to understand more about how an entity has arrived at its financial performance and position for a period.

In order to allow stakeholders to fully understand the development of the company's business, International Financial Reporting Standard (IFRS) 8 "operating segments", requires certain entities to provide segmental analysis of information which discloses revenues, profits and assets by major business area.

IFRS 8 is only compulsory for entities whose debt or equity instruments are traded in a public market or entities filing or in the process of preparing financial statements for the purpose of getting listed.

Required:

With reference to International Financial Reporting Standard (IFRS) 8 "operating segments", highlight six key disclosures required for the discrete financial information. (6 marks)

(b) Babito Limited, a public limited company has a called up and paid up capital comprising of 2 million ordinary shares of Sh.10 each and 400,000, 8% redeemable preference shares of Sh.15 each on 1 January 2018.

The company had also in issue Sh.5 million, 10% convertible bond, to be converted at any time at the holders' option into 15 ordinary shares of Sh.10 each for every Sh.100 of the bond.

The following transactions took place during the year ended 31 December 2018:

1. During the year, the group reported profit after tax of Sh.3,480,000 which included a loss after tax from discontinued operations of Sh.420,000.
2. On 1 April 2018, Babito Limited made a one for every four rights issue of ordinary shares to the existing shareholders at a concessionary price of Sh.36 per right. The market price of the company's share on the last day quotation on cumrights price basis was Sh.41.
3. On 1 August 2018, the company issued 1.2 million ordinary shares for a full market price as a consideration for the acquisition of an overseas property.
4. On 1 October 2018, holders of Sh.2 million, 10% convertible bond exercised their conversion option and were issued with ordinary shares at that date.

The corporation tax rate is at 30%.

Required:

(i) Basic earnings per share (BEPS) for the year ended 31 December 2018. (4 marks)

(ii) Diluted earnings per share (DEPS) for the year ended 31 December 2018. (4 marks)

(c) John Mundia, a financial analyst at Beta Capital has been provided with the following results for Panrama Limited for the year ended 31 December 2018:

Net profit margin ratio	0.04
Total asset turnover ratio	2.20
Total assets/equity ratio	2.40
Earnings per share (Sh.)	2.75
Dividends per share (Sh.)	1.25

Required:

The estimated growth rate for the company. (2 marks)

(d) Maria and Lynette are discussing accounting for income taxes. They are currently studying a schedule of taxable and deductible amounts that will arise in the future as a result of existing temporary differences. The schedule is as follows:

		Future years			
	2018	**2019**	**2020**	**2021**	**2022**
Taxable income (Sh.)	850,000				
Taxable amounts (Sh.)		375,000	375,000	375,000	375,000
Deductible amounts				(2,400,000)	
Enacted tax rate	30%	32%	33%	30%	25%

Required:

Explain the concept of future taxable amounts and future deductible amounts as illustrated in the above schedule. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) A company's financial statements are the most objective way to assess the health of an organisation. As the old adage says "numbers don't lie". Numbers can indicate prosperity or poverty, but they can also show the first signs of trouble within a company.

In relation the above statement, summarise six red flags that could indicate trouble for a business. (6 marks)

(b) The following are the extracts from the statements of financial position for Global Manufacturing Corporation for the years ended 31 December 2017 and 31 December 2018:

Statement of financial position as at 31 December:

	2018 Sh."000"	2017 Sh."000"
Assets:		
Current assets:		
Cash	73,000	22,000
Accounts receivable	82,000	66,000
Inventory	180,000	189,000
	335,000	277,000
Non-current assets:		
Land and buildings	71,000	110,000
Equipment	260,000	200,000
Accumulated depreciation - equipment	(69,000)	(42,000)
	262,000	268,000
Total assets	597,000	545,000
Liabilities and shareholder's equity:		
Accounts payable	34,000	47,000
Bonds payable	150,000	200,000
Ordinary shares (Sh.1 par value)	214,000	164,000
Retained earnings	199,000	134,000
Total liabilities and shareholders equity	597,000	545,000

Additional information:

1. Net income for 2018 was Sh.125,000,000. No gains and losses were recorded in the year 2018.
2. Cash dividends amounting to Sh.60,000,000 was declared and paid.
3. Bonds payable amounting to Sh.50,000,000 were retired through issuance of ordinary shares.

Required:

(i) Statement of cash flows in accordance with the requirements of the International Accounting Standard (IAS) 7, "Statements of Cash Flows". (7 marks)

(ii) Current cash debt coverage ratio. (2 marks)

(iii) Cash debt coverage ratio. (2 marks)

(iv) Free Cash Flow (FCF). (2 marks)

(v) Comment on the firm's liquidity and financial flexibility based on your results obtained in (b) (i) to (b) (iv) above. (1 mark)

(Total: 20 marks)

QUESTION FOUR

(a) A foreign subsidiary was created on 31 December 2017. The LC is the currency of the country in which the foreign subsidiary is located. The subsidiary's statement of financial position as at 31 December 2017 and 31 December 2018 and income statement for the year ended 31 December 2018 are shown below:

Statement of financial position as at 31 December:

	2017 (LC)	2018 (LC)
Cash	5,000	8,000
Inventory	25,000	25,000
Total assets	30,000	33,000

	2017 (LC)	2018 (LC)
Equity and liabilities:		
Accounts payable	20,000	20,000
Ordinary shares	10,000	10,000
Retained earnings	-	3,000
Total equity and liabilities	30,000	33,000

Income statement for the year ended 31 December 2018:

Revenue	15,000
Expenses	(12,000)
Net income	3,000

The following price indices are available:

31 December 2017	100
31 December 2018	150
Average for 2018	125

Required:
Prepare an inflation adjusted:

(i) Statement of financial position as at 31 December 2018. (4 marks)

(ii) Income statement for the year ended 31 December 2018. (3 marks)

(b) Sunny Limited issued a redeemable debt instrument on 1 July 2017 at its par value of Sh.6 million. The instrument carries a fixed coupon interest rate of 6% which is payable annually in arrears. The debt instrument will be redeemed for Sh.6.02 million on 30 June 2021. Transaction costs associated with the issue were Sh.200,000 and were paid at the time of issue. The effective interest rate applicable to this liability is approximately 7.06%.

Required:

(i) Explain how this instrument will be initially measured and subsequently measured. (2 marks)

(ii) Calculate the carrying value of this liability to be included in Sunny Limited's statement of financial position as at 30 June 2019. (Round all workings to the nearest thousand). (4 marks)

(c) Triple D Limited operates a defined benefit pension plan for its employees. At 1 July 2017, the fair value of the pension plan assets was Sh.1,200,000 and the present value of the plan liabilities was Sh.1,400,000. The interest cost on the plan liabilities was estimated at 7% and the expected return on plan assets was estimated at 4%.

The actuary estimates that the current service cost for the year ended 30 June 2018 shall be Sh.300,000. Triple D Limited made contributions into the pension plan of Sh.400,000 in the year ended 30 June 2018. The pension plan paid Sh.220,000 to retired members in the year to 30 June 2018. At 30 June 2018, the fair value of the pension plan assets was Sh.1,400,000 and the present value of the plan liabilities was Sh.1,600,000.

In accordance with International Accounting Standard (IAS) 19, "Employee Benefits", Triple D Limited recognises actuarial gain and losses in other comprehensive income in the period in which they occur.

Required:

(i) The net expense that will be included in Triple D Limited's income statement for the year ended 30 June 2018. (2 marks)

(ii) The amounts that would be included in other comprehensive income in respect of actuarial gains or losses for the year ended 30 June 2018. (5 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following information was extracted from the financial records of TBT Limited, a business which provides technical support services to customers worldwide:

Extracts of income statement for the years ended 31 March:

	2019 Sh."million"	2018 Sh."million"
Sales revenue	3,627	3,908
Cost of sales	(2,765)	(2,886)
Gross profit	862	1,022

Extracts of statement of financial position as at 31 March:

	2019 Sh."million"	2018 Sh."million"
Current assets:		
Inventories	271	330
Trade receivables	632	719
Short-term deposits and cash	342	242
	1,245	1,291
Current liabilities:		
Loans and overdrafts	54	135
Tax payable	113	128
Accruals	20	29
Trade payables	512	479
	699	771

Required:

(i) Horizontal analysis for income statement for the year ended 31 March 2019. (2 marks)

(ii) Horizontal analysis for the statements of financial position as at 31 March 2019. (4 marks)

(iii) Current ratios for the financial years 2018 and 2019. (2 marks)

(iv) Quick ratio for the financial years 2018 and 2019. (2 marks)

(b) The following is a draft statement of financial position of Mawingu Limited as at 31 December 2018:

Statement of financial position as at 31 December 2018:

	Sh."000"
Assets:	
Non-Current assets:	
Property, plant and equipment (net)	20,000
Intangible assets	4,000
	24,000
Current assets:	
Cash	1,000
Marketable securities	500
Accounts receivable	5,000
Inventories	3,500
	10,000
Total assets	34,000
Equity and liabilities:	
Current liabilities:	
Accounts payable	3,000
Notes payable	2,000
Total current liabilities	5,000
Non-current liabilities:	
Long-term debt	10,000
Ordinary shares (1,000,000 shares)	7,000
Retained earnings	12,000
	29,000
Total equity and liabilities	34,000

Additional information:

1. Inventories are valued at cost as determined using Last in first out (LIFO) method. The LIFO reserve is Sh.500,000.
2. Additional operating facilities and equipment are financed with operating leases that have a present value of Sh.5,000,000.
3. Intangible assets represent Sh.4,000,000 of goodwill from previous acquisitions.
4. Due to an increase in interest rates, Mawingu Limited's long-term debt has a current market value of Sh.9,500,000.

Required:

(i) Adjusted statement of financial position as at 31 December 2018. (6 marks)

(ii) Book value per share before and after adjustment. (2 marks)

(iii) Ratio of long-term debt to equity before and after adjustment. (2 marks)

(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 29 November 2018. **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) According to International Accounting Standard (IAS) 32:, "Financial Instruments: Presentation", the issuer of a financial instrument must classify it as either a financial liability or equity instrument on initial recognition according to its substance.

Required:
With reference to the above statement, describe the accounting treatment of a compound instrument on initial recognition and on subsequent measurement. (8 marks)

(b) Godin Limited is a public limited company with a portfolio of investments in many other entities. The extracts from its most recent financial statements are as set out below:

Income statement for the year ended 31 October:

	2018 Sh."000"	2017 Sh."000"
Revenue	126,000	175,000
Cost of sales	(84,000)	(105,000)
Gross profit	42,000	70,000
Profit on disposal of a subsidiary	3,500	-
Distribution costs	(12,250)	(18,550)
Administrative expenses	(16,800)	(10,150)
Finance costs	(1,400)	(2,800)
Profit before tax	15,050	38,500
Income tax expense	(4,550)	(11,550)
Profit for the year	10,500	26,950

Statement of financial position as at 31 October:

	2018 Sh."000"	2017 Sh."000"
Non-Current assets:		
Property, plant and equipment	57,050	66,500
Intangible asset - goodwill	-	7,000
	57,050	73,500
Current assets:		
Inventories	11,900	20,300
Trade receivables	4,550	8,400
Cash and cash equivalents	5,250	-
	21,700	28,700
Total assets	78,750	102,200
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.10 each	35,000	35,000
Retained earnings	10,500	14,000
	45,500	49,000
Non-current liabilities:		
10% debentures	14,000	28,000
Current liabilities:		
Bank overdraft	-	4,900
Trade and other payables	15,050	10,850
Current tax payable	4,200	9,450
	19,250	25,200
Total equity and liabilities	78,750	102,200

Additional information:

1. On 1 November 2017, Godin Limited sold the net assets (including goodwill) of a 100% owned subsidiary for Sh.28 million cash on which it reported a gain of Sh.3.5 million. This disposal required approval by the shareholders of the parent entity. In order to achieve this, the directors of Godin Limited offered the shareholders a dividend of Sh.1.40 for each share in issue out of these disposal proceeds.

   The trading results of the discontinued subsidiary indicated above, which are included in the income statement for the year ended 31 October 2017 were:

	Sh."000"
Revenue	63,000
Cost of sales	(35,000)
Gross profit	28,000
Distribution costs	(3,500)
Administrative expenses	(4,200)
Profit before interest and tax	20,300

2. The following selected ratios for Godin Limited have been calculated for the year ended 31 October 2017:

Gross profit margin	40%
Return on capital employed	53.6%
Operating profit margin	23.6%
Net assets turnover	2.27 times

Required:

Compute the equivalent ratios for Godin group for the year ended:

(i) 31 October 2017 after excluding the consideration/contribution made by the disposal of the subsidiary. (4 marks)

(ii) 31 October 2018, excluding the gain on disposal of the subsidiary. (4 marks)

(iii) Based on the computed ratios in (b) (i) and (b) (ii) above, assess the comparative financial performance and financial position of Godin group as at 31 October 2018. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) Differentiate between the "auditor's report" and the "management commentary". (4 marks)

(b) ABC Company is evaluating a lease arrangement being offered by TKM Company for use of a computer system. The lease is non-cancellable and in no case will ABC Company receive title to the computer system during or at the end of the lease term. The lease starts on 1 January 2018, with the first rental payment due on 1 January 2018.

Additional information relating to the lease is as follows:

Yearly rental payments	Sh.3,557.25 million.
Lease term	3 years.
Estimated economic life	5 years.
Purchase option	Sh.3,000 million at the end of 3 years, which approximates fair value.
Renewal option	1 year at Sh.1,500 million, no penalty for non-renewal as per standard renewal clause.
Fair value at inception of lease	Sh.10,000 million.
Cost of asset to lessor	Sh.10,000 million.
Residual value:	
Guaranteed	Nil.
Unguaranteed	Sh.3,000 million.
Lessor's implicit rate (known by the lessee)	12%.
Executory costs paid by lessor	Sh.500 million per year and is included in the yearly rental payments.
Estimated fair value at the end of lease	Sh.3,000 million.

Required:

Analyse the lease capitalisation criteria for this lease for ABC Company. (6 marks)

(c) Omondi Enterprises Ltd., designs and manufactures locally made suits and the company's primary market is abroad. Sales have increased drastically in recent years. Such drastic growth has significant implications for cash flows. Provided below are the cash flow statements for the company for two recent years:

	Current year Sh.	Prior year Sh.
Cash flows from operating activities:		
Net income	17,523	838,955
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	(69,524)	(146,590)
Depreciation and amortisation	316,416	181,348
Changes in assets and liabilities:		
Accounts receivable	(38,267)	(25,947)
Inventories	(1,599,014)	(1,289,293)
Prepayments and other current assets	(444,794)	(113,205)
Deposits and other assets	(24,240)	(83,044)
Accounts payable	2,017,059	(284,567)
Accrued expenses	61,321	170,755
Accrued interest payable (debentures)	-	(67,179)
Income taxes payable	-	117,810
Net cash used for operating activities	236,480	(700,957)
Net cash used for investing activities	(2,102,892)	(4,422,953)
Net cash used for financing activities	(315,353)	9,685,435
Net change in cash and cash equivalents	(2,181,765)	4,561,525
Other information:		
Current liabilities	4,055,465	1,995,600
Total liabilities	4,620,085	2,184,386
Net sales	20,560,566	17,025,856

Required:

(i) Noting that net income in the current year was only Sh.17,523 compared to prior year net income of Sh.838,955, but net cash flow from operating activities was Sh.236,480 in the current year and a negative Sh.700,957 in the prior year;

Explain the causes of this apparent paradox. (4 marks)

(ii) Evaluate the firm's liquidity, solvency and profitability for the current year using cash flow based ratios. (6 marks)

(Total: 20 marks)

QUESTION THREE

(a) Entities have a choice of the accounting policy they may wish to use in the preparation of financial statements. However, the financial results of an entity could be altered significantly by the choice of the accounting policy.

Required:

With reference to the above statement, identify three key limitations of ratio analysis. (6 marks)

(b) The following information was extracted from the financial records of Mickeyland Limited:

	Sh."000"
Revenue	1,857,000
Profit before interest and tax	298,500
Interest on loan	16,500
Income tax expense	69,000
Total assets	2,595,000
Shareholders' equity	1,506,000
Loan capital	243,000

Required:

The company's return on equity (ROE) using the three-step DuPont analysis. (4 marks)

(c) Wingstone Limited bought a drilling machine for Sh.7.2 million on 1 April 2016. The machine had an estimated economic useful life of six years on that date and a straight line depreciation to a nil residual value was provided.

On 1 April 2017, Wingstone Limited sold the machine to Whitesands Limited for Sh.8,880,000 at its fair value.

Wingstone Limited immediately leased the machine back from Whitesands Ltd. for five years (the remainder of its useful life) at a rental of Sh.1,920,000 per annum payable in arrears. The present value of the annual lease payments at the inception of the leaseback amounted to Sh.8.4 million at an implicit interest rate of 4.625%.

The transaction satisfies the International Financial Reporting Standard (IFRS) 15: Revenue from Contracts with Customers.

Required:

(i) The amount of the gain that Wingstone Limited should recognise for the year ended 31 March 2018 in respect of the sale and leaseback. (4 marks)

(ii) The extracts of financial statements of Wingstone Limited for the year ended 31 March 2018 to account for the right-of-use asset and lease liability. (6 marks)

(Total: 20 marks)

QUESTION FOUR

(a) In relation to stock compensation plan, discuss three advantages of restricted stock plans. (6 marks)

(b) On 1 June 2015, Juhudi Ltd. and Jamii Ltd. merged to form Jumii Ltd. A total of 800,000 shares were issued to complete the merger.

On 1 April 2017, the new corporation issued an additional 400,000 shares of stock and cash. All 1,200,000 shares were outstanding on 31 December 2017. Jumii Ltd. also issued Sh.600,000 of 20 year, 8% convertible bonds at par on 1 July 2017. Each Sh.1,000 bond converts to 40 ordinary shares at any interest date. None of the bonds have been converted to date. For the year ended 31 December 2017, the annual report indicated that the company had an after-tax net income of Sh.1,540,000. The tax rate is 30%.

Required:

The firm's diluted earnings per share (EPS). (8 marks)

(c) The following are the comparative income and retained earnings statements, for Pingu Ltd. for the years 2016 and 2017:

	2017	**2016**
	Sh.	**Sh.**
Sales	340,000	270,000
Cost of sales	(200,000)	(142,000)
Gross profit	140,000	128,000
Expenses	(88,000)	(50,000)
	52,000	78,000
Retained earnings (1 January)	125,000	72,000
Net income	52,000	78,000
Dividends	(30,000)	(25,000)
Retained earnings (31 December)	147,000	125,000

Additional information:

1. In the year 2017, Pingu Ltd. decided to switch its depreciation method from sum-of-the years' digits to the straight-line method.

   The assets were purchased at the beginning of year 2016 for Sh.100,000 with an estimated useful life of 4 years and no salvage value. The year 2017 income statement contains depreciation expense of Sh.30,000 on the assets purchased at the beginning of year 2016.
2. In the year 2017, Pingu Ltd. discovered that the ending inventory for the year 2016 was overstated by Sh.24,000.
3. The ending inventory for the year 2017 was correctly stated.

Required:

The revised earnings statement for the years 2016 and 2017. (Ignore income taxes). (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain the term "earnings quality" in relation to accrual component of earnings and earnings management. (2 marks)

(b) On 1 October 2016, HM Ltd. acquired 2,000,000 ordinary shares of SJ Ltd. by paying Sh.4.50 per share. As at the date of acquisition, the retained earnings of SJ Ltd. were Sh.4,200,000.

The draft statements of financial position of the two companies as at 30 September 2018 were as follows:

	HM Ltd. Sh."000"	SJ Ltd. Sh."000"
Assets:		
Non-current assets:		
Land	11,000	6,000
Plant and equipment	10,225	5,110
Investment in SJ Ltd.	9,000	-
	30,225	11,110
Current assets:		
Inventories	4,925	3,295
Trade receivables	5,710	1,915
Cash	495	-
	11,130	5,210
Total assets	41,355	16,320
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.1 each	5,000	2,500
Retained earnings	25,920	8,290
	30,920	10,790
Non-current liabilities:		
10% loans	6,000	2,000
Current liabilities:		
Trade payables	3,200	2,255
Bank overdraft	-	285
Corporation tax	1,235	990
	4,435	3,530
Total equity and liabilities	41,355	16,320

Additional information:

1. Extracts from the income statement of SJ Ltd. before inter-group adjustments for the year ended 30 September 2018 are as follows:

	Sh."000"
Profit before tax	2,700
Corporation tax	(800)
Profit after tax	1,900

2. During the year, SJ Ltd. sold goods to HM Ltd. for Sh.900,000. SJ Ltd. adds a 20% mark-up on cost to all its sales. Goods with a transfer price of Sh.240,000 were included in HM Ltd.'s inventories as at 30 September 2018.
3. The fair value of SJ Ltd.'s land, plant and equipment at the date of acquisition was Sh.1,000,000 and Sh.2,000,000 respectively in excess of the carrying values. SJ Ltd.'s statement of financial position has not taken account of these fair values. The group depreciation policy is that land should not be depreciated while plant and equipment should be depreciated at the rate of 10% per annum on fair value.
4. During the year, an impairment review was carried out on the consolidated goodwill and it was found that the goodwill had been impaired by Sh.400,000 as at 30 September 2018.

Required:

(i) Determine the value of goodwill arising on acquisition of SJ Ltd. (5 marks)

(ii) HM Ltd. group consolidated statement of financial position as at 30 September 2018. (13 marks)

(Total: 20 marks)

....

Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8065	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	.5739	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	.5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	.3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	.1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	.0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	.1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	.0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0318	.0221	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1 - \frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 24 May 2018. **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) Distinguish between "top-down approach" from "bottom-up approach" techniques of analysing financial statements by outlining the salient steps followed in each approach. (6 marks)

(b) Neptune Holdings is an entity that operates in the wholesale and retail clothing market sectors across several countries. The firm prepares its financial statements in accordance with the requirements of International Financial Reporting Standards (IFRSs). The directors are considering listing Neptune Holdings on a local securities exchange within the next twelve months. One of the directors has raised concerns about the costs associated with being a listed entity, in particular the additional expense of producing operating segment information.

Required:

(i) Explain how the requirements of IFRS 8 "Operating Segments" assist entities in minimising the cost of producing the operating segment disclosures required by the standard. (2 marks)

(ii) Discuss three benefits that could accrue to the investors from reviewing the operating segment disclosures of Neptune Holdings when making investment decisions. (6 marks)

(iii) Describe two potential limitations that could be faced by investors using operating segment information when making investment decisions. (2 marks)

(c) A motor vehicle manufacturing company commenced operations on 1 January 2017. The following information relates to the company for the financial year ended 31 December 2017:

1. Research and development costs related to software development for internal purposes amounted to Sh.750,000.
2. Start-up costs amounted to Sh.1,200,000.
3. Direct response advertising costs totalled to Sh.225,000.
4. Research and development related to developing a new car model amounted to Sh.500,000.
5. Testing of the prototype model is scheduled for June 2018.
6. Start-up costs have an estimated period of benefits of two years, advertising three years while research and development is estimated at five years.

Required:

Calculate the amount that should be expensed in the company's financial statements for the year ended 31 December 2017. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) The following financial statements were extracted from the books of Melinda Limited:

Statement of comprehensive income for the year ended 31 March 2018

	Sh."million"
Revenue	5,740
Cost of sales	(4,840)
Gross profit	900
Other income	60
Distribution cost	(120)
Administrative expenses	(350)
Finance cost	(50)
Profit before tax	440
Income tax expense	(160)
Profit for the year	280

Other comprehensive income:	
Gain on property revaluation	100
Total comprehensive income	380

Statements of financial position as at 31 March:

	2018		2017	
Non-current assets:	Sh. "million"	Sh. "million"	Sh. "million"	Sh. "million"
Property, plant and equipment		2,880		1,860
Investment property		420		400
		3,300		2,260
Current assets:				
Inventory	1,210		810	
Accounts receivable	480		540	
Deferred tax asset	Nil		50	
Bank	10	1,700	Nil	1,400
		5,000		3,660
Equity and liabilities:				
Ordinary share capital		1,000		600
Share premium		600		Nil
Revaluation reserves		150		50
Retained earnings		1,440		1,310
		3,190		1,960
Non-current liabilities:				
6% Debentures	Nil		400	
Deferred tax	50	50	30	430
Current liabilities:				
Accounts payable	1,410		1,050	
Bank overdraft	Nil		120	
Warranty provision	200		100	
Current tax payable	150	1,760	Nil	1,270
		5,000		3,660

Additional information:

1. An item of plant with a carrying value of Sh.240 million was sold at a loss of Sh.90 million during the year. Depreciation of Sh.280 million was charged to cost of sales for property, plant and equipment in the year ended 31 March 2018.
   The company uses the fair value model as per International Accounting Standard (IAS) 40: Investment Property.
   There was no acquisition or disposal of investment property during the year.
2. The 6% debentures were redeemed early incurring a penalty payment of Sh.20 million which has been charged as an administrative expense in the income statement.
3. Other incomes comprise:
   - Investment income of Sh.40 million.
   - Revaluation gain of investment property of Sh.20 million.
4. Melinda Limited gives a 12 month warranty on some of the products it sells. The amount shown in current liabilities as warranty provision are an accurate assessment based on past experience of the amount of claims likely to be made in respect of warranties outstanding at each year end. Warranty costs are included in cost of sales.

Required:

(a) A statement of cash flows for the year ended 31 March 2018 in accordance with the requirements of the International Accounting Standard (IAS) 7, Statement of Cash Flows. (14 marks)

(b) Comment on the cash flow management of Melinda Limited as revealed by the statement of cash flows in (a) above and the information provided by the above financial statements. (6 marks)

(Total: 20 marks)

QUESTION THREE

(a) Pauline Nangila and Johnson Mugecha are discussing the recent fraud that occurred at AKIP Limited. The fraud involved the improper reporting of revenue to ensure that the company would have income in excess of Sh.1 billion.

Required:

(i) Explain the term "fraudulent financial reporting". (2 marks)

(ii) Evaluate five ways in which fraudulent financial reporting differs from an embezzlement of company's funds. (5 marks)

(b) (i) Examine two reasons why the components of income tax expense should be disclosed and a reconciliation between the effective tax rate and the statutory tax rate be provided. (2 marks)

(ii) Baobab Cement Limited reported a pre-tax income of Sh.70 million for the year 2017. The following items caused taxable income to be different from pre-tax financial income reported:

1. Depreciation on the tax return was greater than depreciation on the income statement by Sh.16 million.
2. Rent collected on the tax return was greater than rent recognised on the income statement by Sh.22 million.
3. Fines for pollution appear as an expense of Sh.11 million on the income statement.

Baobab Cement Limited's tax rate is 30% for all years and the company expects to report taxable income in all future years. There are no deferred taxes at the beginning of the year 2017.

Required:
Compute the effective income tax rate for the year 2017. (6 marks)

(c) Shadrack Magu, a financial analyst at Beta Capital has gathered the following information about ABC Limited for the year ended 31 December 2017:

1. Net income for the year was Sh.130 million.
2. Outstanding number of ordinary shares for the entire year was 3 million.
3. The company had 1.2 million, 9%, Sh.100 par value preference shares for the entire year with each preferred share being convertible into 5 ordinary shares.
4. The corporate tax rate is 30%.

Required:
(i) Basic earnings per share (EPS). (2 marks)

(ii) Diluted earnings per share (EPS). (3 marks)
(Total: 20 marks)

QUESTION FOUR
Western Corporation was formed 5 years ago through a public subscription of ordinary shares. Douglas Wekesa who owns 15% of the ordinary shares is the current chairman of Western Corporation. The company has been successful, but is currently experiencing a shortage of funds. On 10 June 2017, Wekesa approached Salama Bank requesting for a 24-month extension on two Sh. 35 million notes, which were due on 30 June 2017 and 30 September 2017. Another note of Sh.6 million was due on 31 March 2018, but he expects no difficulty in paying this note on its due date. Wekesa explained that Western Corporation's cash flow problems were due primarily to the company's desire to finance a Sh.300 million plant expansion over the next two financial years through internally generated funds.

The commercial loan officer of Salama Bank obtained the following financial reports of the company for the last two financial years:

Western Corporation
Statement of financial position as at 31 March:

Assets:	**2017**	**2016**
	Sh."000"	**Sh."000"**
Cash	18,200	12,500
Notes receivable	148,000	132,000
Accounts receivable (net)	131,800	125,500
Inventories (at cost)	105,000	50,000
Plant and equipment	1,449,000	1,420,500
Total assets	1,852,000	1,740,500
Liabilities and stockholders' equity:		
Accounts payable	79,000	91,000
Notes payable	76,000	61,500
Accrued liabilities	9,000	6,000
Ordinary shares (130 million shares, Sh.10 par)	1,300,000	1,300,000
Retained earnings	388,000	282,000
	1,852,000	1,740,500

Western Corporation
Income statement
For the financial year ended 31 March

	2017 Sh."000"	2016 Sh."000"
Sales revenue	3,000,000	2,700,000
Cost of goods sold	(1,530,000)	(1,425,000)
Gross profit margin	1,470,000	1,275,000
Operating expenses	(860,000)	(780,000)
Income before income taxes	610,000	495,000
Income taxes	(244,000)	(198,000)
Net income	366,000	297,000

Additional information:

1. Cash dividends were paid at the rate of Sh.1 per share in the financial year 2016 and Sh.2 per share in the financial year 2017.
2. Depreciation charges on the plant and equipment of Sh.100 million and Sh.102.5 million for the financial years ended 31 March 2016 and 31 March 2017 respectively are included in the cost of goods sold.

Required:

(a) Compute the following items for Western Corporation:

(i) Current ratio for financial year 2016 and 2017. (2 marks)

(ii) Acid-test (quick) ratio for the financial year 2016 and 2017. (2 marks)

(iii) Inventory turnover for financial year 2017. (2 marks)

(iv) Return on asset (ROA) for financial year 2016 and 2017 (Assume total assets were Sh.1,688,500,000 as at 31 March 2015). (2 marks)

(v) Percentage change in sales, cost of goods sold, gross profit margin and net income after taxes from financial year 2016 to 2017. (4 marks)

(b) Propose two financial reports and or financial analysis that might be helpful to the commercial loan officer of Salama Bank in evaluating Wekesa's request for a time extension on Western Corporation's notes. (2 marks)

(c) Assume that the percentage change experienced in the financial year 2017 as compared with financial year 2016 for sales and cost of goods sold will be repeated in each of the next 2 years.

Determine whether Western Corporation's desire to finance plant expansion from internally generated funds is realistic. (5 marks)

(d) Determine whether Salama Bank should grant the extension on Western Corporation's notes considering Wekesa's statement about financing the plant expansion through internally generated funds. (1 mark)

(Total: 20 marks)

QUESTION FIVE

(a) Complex Machineries Limited leased a new model of a machine under the following terms:

1. Four year lease with annual end of year payments of Sh.10,000.
2. At the end of the lease, the lessor regains possession, and the asset is expected to be sold at scrap value.
3. The discount rate on the lease is 6%.
4. The company's incremental borrowing rate is 7%.
5. The company depreciates all its assets on a straight-line basis.
6. Useful life of the machine is 5 years.

Required:

Illustrate how the above lease would be reported in the company's statement of financial position and income statement for each of the next four years. (4 marks)

(b) In relation to the International Financial Reporting Standard (IFRS) 5, "Non-current Assets Held for Sale and Discontinued Operations":

(i) Highlight three conditions that must be met for an asset to be classified as held for sale. (3 marks)

(ii) Allied group operates hotel chain within East Africa. After a period of declining profitability, the directors made the following decisions during the year ended 30 April 2018:

1. To dispose of all of its hotels in Rwanda.
2. To refurbish all of its hotels in Kenya in order to target the business clients market. The previous target market in Kenya had been aimed at the holiday and tourism market.

Required:
Treating the two decisions separately, explain whether they meet the criteria for being classified as discontinued operations in the financial statements for the year ended 30 April 2018. (3 marks)

(c) The following are the extracts from the financial statements of Zoo Limited and Niqe Limited for the year ended 31 December 2017:

Summarised income statement and statement of other comprehensive income for the year ended 31 December 2017:

	Zoo Limited Sh."million"	Niqe Limited Sh."million"
Profit from operations	290	140
Finance costs	(45)	(8)
Profit before tax	245	132
Income tax expense	(80)	(32)
Profit for the year	165	100
Other comprehensive income:		
Items that may be reclassified to profit or loss:		
Gains on sale of investment	2	
Items that will not be reclassified to profit or loss:		
Revaluation of property, net of tax	60	20
Other comprehensive income for the year	62	20
Total comprehensive income	227	120

Additional information:
1. Zoo Limited acquired 40% of the equity share capital of Niqe Limited for Sh.270 million in the year 2014 when the fair value of the net assets of Niqe Limited was Sh.600 million. Zoo Limited acquired a further 30% of the equity share capital of Niqe Limited for Sh.260 million on 1 October 2017 when the fair value of the net assets was Sh.800 million. The fair value of the initial 40% investment in Niqe Limited was Sh.390 million as at 1 October 2017. There has been no impairment of the investments in Niqe Limited.
2. Assume that profits, gains and losses accrue evenly throughout the year.
3. It is the group's policy to measure the non-controlling interest at its proportionate share of the fair value of the net assets acquired.

Required:
Group consolidated income statement and other comprehensive income for the year ended 31 December 2017.
(10 marks)
(Total: 20 marks)

....

Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	9901	.9804	.9709	9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	8772	.8696	.8621	8475	.8333	8065	7813	7576	7353
2	.9803	.9612	.9426	9246	.9070	.8900	8734	.8573	.8417	.8264	7972	7695	.7561	.7432	.7182	.6944	.6504	.6104	5739	5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	6750	6575	.6407	.6086	.5787	.5245	.4768	4348	3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	5921	.5718	.5523	.5158	.4823	.4230	.3725	3294	2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	6806	.6499	.6209	.5674	5194	.4972	.4761	.4371	.4019	.3411	2910	2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	3075	.2843	.2630	.2255	1938	.1443	.1084	.0822	0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	3855	.3220	.2697	2472	.2267	.1911	.1615	.1164	.0847	.0623	0462
11	8963	8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	3555	.3186	.2567	.2076	.1869	1685	1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	8613	.7430	.6419	.5553	.4810	.4173	.3624	3152	.2745	.2394	.1827	1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	1069	.0930	0708	.0541	.0320	.0193	.0118	0073
17	8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	0168	.0092	.0051	0029
20	8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	1486	1037	.0728	.0611	.0514	.0365	0261	.0135	.0072	.0039	.0021
25	.7798	.6095	4776	.3751	.2953	.2330	.1842	1460	.1160	.0923	.0588	0378	.0304	.0245	0160	0105	.0046	.0021	.0010	0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	0196	.0151	.0116	.0070	.0042	.0016	0006	.0002	.0001
40	.6717	.4529	3066	.2083	.1420	.0972	.0668	0460	.0318	.0221	.0107	.0053	.0037	.0026	0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	0134	.0085	.0035	.0014	0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1-\frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

kasneb

CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 30 November 2017. **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) The role of financial statements analysis is to use financial reports prepared by companies, combined with other information, to evaluate the past, current and potential performance and financial position of a company for the purpose of making investment, credit and other economic decisions.

In relation to the above statement, analyse four types of economic decisions that a financial analyst could make from the financial statements of a company. (4 marks)

(b) (i) Explain the term "earnings management". (2 marks)

(ii) John Kitili, a financial analyst at Rich Investment Firm has been presented with the following data from the statement of financial position of Mwenja Dairy Limited for analysis:

Mwenja Dairy Limited statement of financial position as at 31 October:

	2017 Sh. "000"	2016 Sh. "000"
Assets:		
Cash	4,400	4,000
Accounts receivable	7,000	6,000
Inventory	8,400	8,000
Non-current assets	27,600	26,000
Total assets	47,400	44,000
Liabilities and equity:		
Accounts payable	3,520	3,200
Short-term notes payable	5,288	4,800
Long-term debt	30,000	30,000
Total liabilities	38,808	38,000
Equity:		
Ordinary shares	4,600	4,000
Retained earnings	3,992	2,000
Total liabilities and equity	47,400	44,000

Required:
The accrual ratio for the year 2017. (4 marks)

(c) The following information relates to Zalip Limited and Avela Limited which operates wholesale stores as at 30 June 2017:

Statement of financial position as at 30 June 2017

	Zalip Limited Sh. "million"	Avela Limited Sh. "million"
Non-current assets:		
Land and buildings	360.0	510.0
Fixtures and fittings	87.0	91.2
	447.0	601.0
Current assets:		
Inventories	592.0	403.0
Trade receivables	176.4	321.9
Cash at bank	84.6	91.6
	853.0	816.5
Total assets	1,300.0	1,417.7

	Sh. "million"	Sh. "million"
Equity and liabilities:		
Equity		
Ordinary shares (Sh.1 each)	320.0	250.0
Retained earnings	367.6	624.6
Total equity	687.6	874.6
Non-current liabilities:		
Borrowings – loan notes	190.0	250.0
Current liabilities:		
Trade payables	406.4	275.7
Taxation	16.0	17.4
	422.4	293.1
Total equity and liabilities	1,300.0	1,417.7

Income statement for the year ended 30 June 2017

	Zalip Limited Sh. "million"	Avela Limited Sh. "million"
Revenue	1,478.1	1,790.4
Cost of sales	(1,018.3)	(1,214.9)
Gross profit	459.8	575.5
Operating expenses	(308.5)	(408.6)
Operating profit	151.3	166.9
Interest payable	(19.4)	(27.5)
Profit before taxation	131.9	139.4
Taxation	(32.0)	(34.8)
Profit for the year	99.9	104.6

Additional information:

1. All purchases and sales were on credit.
2. Zalip Limited and Avela Limited had announced their intention to pay dividends of Sh.135 million and Sh.95 million respectively in respect of the year 2017.
3. The market value of a share in Zalip Limited and Avela Limited at the end of the year were Sh.6.50 and Sh.8.20 respectively.

Required:
For each business, calculate two ratios that are concerned with each of the following aspects:

(i) Profitability. (2 marks)

(ii) Efficiency. (2 marks)

(iii) Liquidity. (2 marks)

(iv) Gearing. (2 marks)

(d) Interpret the ratios computed in (c) (i) to (c) (iv) above. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) Evaluate four factors that could contribute to the reliability of financial statements. (4 marks)

(b) Benson Kilonzo, a financial analyst at ABC Capital has been presented with the following financial statements of Venus Limited for analysis:

Venus Limited
Income statement for the year ended 31 October 2017

	Sh.
Revenue	3,257,489
Cost of sales	(840,204)
Gross profit	2,417,285
Less expenses:	
Salaries and wages	1,036,005
Rent and lighting	123,467
General administrative expenses	783,969
Total operating expenses	(1,943,441)
Earnings before interest, tax, depreciation and amortisation (EBIDA)	473,844

	Sh.
Depreciation and amortisation	(156,368)
Earnings before interest and tax (EBIT)	317,476
Interest and other expenses	(31,089)
Pre-tax income	286,387
Income taxes	(85,642)
Net income	200,745

Venus Limited
Statement of financial position as at 31 October:

	2016	2017
Non-current assets:	**Sh.**	**Sh.**
Land and buildings	1,694,720	1,774,550
Plant and equipment	618,084	663,472
Motor vehicles	15,001	23,965
	2,327,805	2,461,987
Accumulated depreciation	(1,295,761)	(1,418,835)
Non-current assets	1,032,044	1,043,152
Goodwill	216,605	252,790
	1,248,649	1,295,942
Current assets:		
Cash	73,633	62,271
Inventory	67,023	70,559
Accounts receivable	46,588	43,944
Total current assets	187,244	176,774
Total assets	1,435,893	1,472,716
Financed by:		
Equity and liabilities:		
Equity:		
Ordinary share capital	507,736	512,735
Retained earnings	(586,196)	(725,834)
Total shareholders' equity	(78,460)	(213,099)
Long-term liabilities:		
Loan notes	970,825	1,113,949
Current liabilities:		
Trade payables	412,112	427,160
Accrued expenses	131,416	144,706
Total liabilities and equity	1,435,893	1,472,716

Required:

(i) Vertical analysis on the income statement for the year ended 31 October 2017. (4 marks)

(ii) Horizontal analysis on the statement of financial position. (4 marks)

(iii) Inventory turnover ratio. (2 marks)

(iv) Cash conversion cycle. (4 marks)

(v) Return on equity (ROE). (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Highlight three conditions to be satisfied before provision is recognised as per the International Accounting Standard (IAS) 37 "provision, contingent liabilities and contingent assets". (3 marks)

(b) Medichem Limited, a public limited company operating in the pharmaceuticals sector intends to achieve economies of scale by entering into a business combination with compatible partner companies. To achieve this objective, Medichem Limited acquired all of the ordinary share capital of Diapharm Limited by way of a share exchange on 1 April 2017. Medichem Limited issued 5 of its own shares for every 4 shares in Diapharm Limited. The market value of Medichem Limited's share on 1 April 2017 was Sh.6 each. The share issue has not been recorded in Medichem Limited's books.

The summarised financial statements of both companies for the year to 30 September 2017 were as follows:

Income statement for the year ended 30 September 2017:

	Medichem Limited Sh. "000"	Diapharm Limited Sh. "000"
Sales revenue	48,000	40,000
Cost of sales	(33,200)	(23,600)
Gross profit	14,800	16,400
Operating expenses	(3,200)	(2,000)
Profit before tax	11,600	14,400
Taxation	(4,000)	(6,000)
Profit for the year	7,600	8,400

Statement of financial position as at 30 September 2017:

	Medichem Limited		Diapharm Limited	
Non-current assets:	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"
Property, plant and equipment		128,000		70,000
Investments		-		25,600
		128,000		95,600
Current assets:				
Inventory	45,600		47,200	
Trade receivables	32,800		48,400	
Bank	1,000	79,400	400	96,000
Total assets		207,400		191,600
Equity and liabilities:				
Ordinary shares (Sh.1 each)		40,000		24,000
Share premium	8,000		4,800	
Retained earnings	114,400	122,400	85,400	90,200
		162,400		114,200
Non-current liabilities:				
8% loan note		10,000		36,000
Current liabilities:				
Trade payables	30,600		35,400	
Taxation	4,400	35,000	6,000	41,400
		207,400		191,600

Additional information:

1. The fair value of Diapharm Limited investment was Sh.10 million in excess of its book value at the date of acquisition.
2. The fair value of Diaphram Limited's other net assets was equal to the book value.
3. Goodwill was reviewed on 30 September 2017. Sh.6 million loss is to be recognised.
4. No dividends have been paid or proposed by either companies.

Required:

(i) Consolidated income statement for the year ended 30 September 2017. (5 marks)

(ii) Consolidated statement of changes in equity for the year ended 30 September 2017. (4 marks)

(iii) Consolidated statement of financial position as at 30 September 2017. (8 marks)

(Total: 20 marks)

QUESTION FOUR

(a) In relation to the International Accounting Standard (IAS) 38 "Intangible Assets":

(i) Define the term "intangible asset". (2 marks)

(ii) Outline three examples of intangible assets. (3 marks)

(b) The following information relates to Golden Cake Limited pension scheme for the year ended 31 October 2017:

Beginning projected benefit obligation (PBO)	Sh.24 million
Fair market value of plan assets	Sh.16 million
Discount rate	9%
Expected return on plan assets	Sh.1.96 million

Anticipated compensation growth rate	4%
End of period actual return on assets	14%
End of period plan assets	Sh.18 million
Service cost for the year	Sh.1.8 million

Note: Ignore amortisation of unrecognised prior service costs and deferred gains and losses.

Required:
Pension expenses for the year ended 31 October 2017. (3 marks)

(c) Milliam Akinyi is a financial analyst at Vinball Limited which operates a defined-benefit retirement plan for its employees. The firm has a relatively young workforce with a low percentage of retirees. She is tasked to analyse the effects of changing assumptions on different variables used to calculate certain pension amounts.

Required:
(i) Describe the impact of an increase in the compensation growth. (2 marks)

(ii) Examine the impact of the funded status in case of a decrease in the discount rate. (1 mark)

(d) Stella Maris, a Certified Financial and Investment Analyst (CIFA) has calculated the following ratios for ABC Limited:

Operating profit margin	17.5%
Net profit margin	11.7%
Total asset turnover	0.89 times
Return on assets	10.4%
Financial leverage	1.46
Debt to equity ratio	0.46

Required:
The company's return on equity (ROE) using DuPont analysis. (2 marks)

(e) In relation to International Accounting Standard (IAS) 10 "Events after the reporting period":

(i) Distinguish between "adjusting event" and "non-adjusting event". (4 marks)

(ii) The current financial year for Damiano Limited ends on 31 March 2017. The company's financial statements were authorised by its directors on 6 May 2017 and the annual general meeting (AGM) was held on 3 June 2017. The following events have been brought to your attention:

On 12 April 2017, a fire completely destroyed the company's largest warehouse and the inventory inside. The carrying amount of the warehouse and the inventory were Sh.20 million and Sh.12 million respectively. It appears that the company had not updated the value of its insurance cover and only expects to be able to recover a maximum of Sh.18 million from its insurers. Damiano Limited trading operations had been severely disrupted since the fire outbreak and it expects large trading losses in the foreseeable future.

Required:
Explain the required treatment of the above item by Damiano Limited in its financial statements for the year ended 31 March 2017. (3 marks)

(Total: 20 marks)

QUESTION FIVE

(a) (i) Explain the term "shenanigan strategies" as used in financial statements analysis. (2 marks)

(ii) Describe two basic strategies underlying accounting shenanigans. (2 marks)

(b) In March 2017, Nebulax Limited acquired 40,000 shares in Jedidah Limited for Sh.2.68 per share. The investment was classified as available for sale on initial recognition. The shares were trading at Sh.2.96 per share on 31 July 2017. The directors of Nebulax Limited are concerned about the value of the company's investment in Jedidah Limited and in an attempt to hedge against the risk of a fall in its value, they are considering acquiring a derivative contract. The directors wish to use hedge accounting in accordance with International Accounting Standard (IAS) 39: "Financial Instruments".

Required:
Explain how both the available for sale investment and any associated derivative contract would be subsequently accounted for, assuming that the criteria for hedge accounting was met, in accordance with IAS 39. (3 marks)

(c) ABK Ltd. a subsidiary of MNC Ltd., prepares its financial statements in AHS currency. The following financial information relates to the two entities for the year ended 30 September 2017:

Statement of financial position as at 30 September 2017:

	MNC Ltd.		ABK Ltd.	
	SHS "million"	SHS "million"	AHS "million"	AHS "million"
Non-current assets:				
Property, plant and equipment	107		164	
Investments (Note 1)	60	167	-	164
Current assets:				
Inventory (Note 2)	70		50	
Accounts receivable	65		60	
Cash and bank balances	25	160	12	122
		327		286
Equity and liabilities:				
Ordinary share capital (1SHS/1 AHS shares)	100		60	
Retained profits	127	227	89	149
Non-current liabilities		65		72
Current liabilities		35		65
		327		286

Statement of comprehensive income for the year ended 30 September 2017

	MNC Ltd.	ABK Ltd.
	SHS "million"	AHS "million"
Revenue	200	240
Cost of sales	(120)	(145)
Gross profit	80	95
Operating expenses	(35)	(40)
Operating income	45	55
Intergroup investment income	4.5	
Finance cost	(7.5)	(10)
Profit before tax	42	45
Income tax expense	(10)	(15)
	32	30

Notes to the financial statements:

Note 1: On 1 October 2014, when the retained earnings of ABK Ltd. showed a credit balance of AHS 38 million, MNC Ltd. purchased 45 million shares of ABK Ltd. for AHS 4 each. At this date, a non-current asset in the books of ABK Ltd. with a carrying value of AHS 50 million was deemed to have a fair value of AHS 80 million. This asset had a remaining useful life of 10 years at this time and depreciation is charged to cost of sales.

Note 2: On 1 September 2017, MNC Ltd. sold computer components to ABK Ltd. for SHS 12 million. These components had a cost of SHS 10 million to manufacture. All of these components were included in the inventory of ABK Ltd. as at 30 September 2017. ABK Ltd. had paid for half of the consignment before the year end and the balance of the liabilities was included in its payables.

Exchange rate on relevant dates were as follows:

Date	Exchange rate: (AHS/SHS)
1 October 2014	3.00
30 September 2016	2.70
1 September 2017	2.45
30 September 2017	2.40

The weighted average exchange rate for the year ended 30 September 2017 was AHS 2.50 = 1 SHS

Required:
MNC Ltd. consolidated statement of comprehensive income for the year ended 30 September 2017. (8 marks)

(d) Radian Limited had 10 million ordinary shares in issue on both 1 January 2016 and 31 December 2016. On 1 January 2016, Radian Limited issued 1.2 million, 1 unit of 5% convertible loan stock. Each unit of stock is convertible into 4 ordinary shares on 1 January 2019 at the option of the holder.

The following is an extract from Radian Limited income statement for the year ended 31 December 2016:

	Sh. "000"
Profit before interest and tax	1,960
Interest payable on 5% convertible stock	(60)
Profit before tax	1,900
Income tax expenses at 30%	(570)
Profit for the year	1,330

Required:

(i) The basic earnings per share (EPS) for the year ended 31 December 2016. (2 marks)

(ii) The diluted earning per share (EPS) for the year ended 31 December 2016. (3 marks)

(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 25 May 2017. **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) Nancy Naliaka, a financial analyst at ABC Capital Investment firm is analysing the financial statements of some companies in the manufacturing sector in her country.

Required:
In relation to the above statement, highlight three different types of information that she could obtain from each of the following sources:

(i) Press release. (3 marks)

(ii) Proxy statements. (3 marks)

(b) Noor Kiptoon, a finance director at Equid Limited is evaluating whether the company should purchase a production plant in cash or through a finance lease.

Additional information:
1. The plant will cost Sh.280 million.
2. The interest rate implicit in the lease is 10% per annum.
3. The finance lease would be repaid in four equal instalments of Sh.80 million each, payable annually in advance commencing 1 January 2017.

Required:
The amount to be included in both the statement of comprehensive income and the statement of financial position for the years ended 31 December 2017 and 31 December 2018. (6 marks)

(c) (i) Distinguish between "taxable temporary differences" and "deductable temporary differences" as used in the computation of income taxes. (2 marks)

(ii) Bitech Ltd. had a deferred tax assets of Sh.20 million as at 1 April 2016.
During the year ended 31 March 2017, the following information was available for computation of deferred tax:

1. Property, plant and equipment had a carrying amount of Sh.600 million and a tax base of Sh.500 million.
2. Trade receivables had been reported at Sh.250 million before making an allowance for doubtful debts of Sh.5 million and exchange gain (unrealised) of Sh.20 million. Both the allowance and exchange gain are not allowed for tax purposes.
3. Trade and other payables stood at Sh.550 million which included accrual of Sh.60 million allowable for tax purposes.
4. Inventory is carried at Sh.150 million before making a provision of 5% on obsolete stock.
5. Intangible assets comprise of patents being amortised over 5 years which had a carrying value of Sh.60 million. This had been allowed for tax purposes when the cost was incurred.

Assume a tax rate of 30%.

Required:
The deferred tax provision for the year ended 31 March 2017. (6 marks)
(Total: 20 marks)

QUESTION TWO

(a) (i) Explain four purposes of financial ratios. (4 marks)

(ii) James Oduor, a financial analyst is examining the performance of Betam Airways and wishes to understand the factors driving the trend in its return on equity (ROE) over a three year period. James obtains the following data from a leading news provider and ascertains that the news provider has included non-operating income in the interest burden factor:

Factor	2016	Year 2015	2014
Return on equity (ROE)	20.62%	14.42%	10.17%
Tax burden	64.88%	62.52%	60.67%
Interest burden	130.54%	112.60%	130.50%
Earnings before interest and tax (EBIT) margin	6.51%	6.40%	4.84%
Asset turnover	1.55	1.38	1.19
Leverage	2.42	2.32	2.24

Required:

Analyse each of the factors driving the trend in return on equity (ROE) over the three year period. (6 marks)

(b) The following are extracts of the financial statements of Aquila Ltd., Leo Ltd. and Orion Ltd. for the year ended 31 December 2016:

Summarised income statements and other income for the year ended 31 December 2016:

	Aquila Ltd. Sh."million"	Leo Ltd. Sh."million"	Orion Ltd. Sh."million"
Profit from operations	580	280	140
Finance costs	(90)	(16)	(20)
Profit before tax	490	264	120
Income tax expense	(160)	(64)	(30)
Profit for the year	330	200	90
Other comprehensive income:			
Items that will not be classified to the income statement:			
Revaluation of property (net of tax)	120	40	20
Other comprehensive income for the year	120	40	20
Total comprehensive income	450	240	110

Additional information:

1. Aquila Ltd. acquired 80% of the equity share capital of Leo Ltd. for Sh.405 million in the year 2013 when the fair value of the net assets was Sh.465 million. The non-controlling interest in Leo Ltd. was measured as its fair value of Sh.100 million at the date of acquisition. Aquila Ltd. conducted an annual impairment review and concluded that the goodwill on the acquisition of Leo Ltd. was impaired by 20% as at 31 December 2016. No previous impairment of goodwill had occurred.
2. Aquila Ltd. established a joint venture entity, Orion Ltd., with one other party on 1 January 2016. Aquila Ltd. is accounting for its 50% share in this joint venture in accordance with the International Accounting Standard (IAS) 28: "Investment in Associates and Joint Ventures".

Required:

(i) The summarised consolidated income statement and other comprehensive income for Aquila Ltd. for the year ended 31 December 2016. (6 marks)

(ii) Aquila Ltd. is planning to acquire 100% of the equity of Delta Ltd., an entity that operates overseas and which currently prepares its financial statements in E Shillings. The directors of Aquila Ltd. intend to require that Delta Ltd. adopts the currency of Aquila Ltd.'s country as its functional currency.

Required:

Explain how the functional currency of Delta Ltd. should be determined under International Accounting Standard (IAS) 21: "The effects of changes in Foreign exchange rates" framework. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) (i) Summarise four conditions that must be satisfied before the revenue from the sale of goods could be recognised as per the International Accounting Standard (IAS) 18: "Revenue". (4 marks)

(ii) Fairmall Technology Limited was awarded a contract to develop a computer software program for a client for a total sales price of Sh.100 million.
The project was to take three years to develop with a total development cost estimated at Sh.60 million.

Additional information:

1. At the end of year 1, the company had spent Sh.30 million, total costs to completion being estimated at Sh.30 million.
2. At the end of year 2, the company had spent an additional Sh.24 million, total costs to completion being estimated at Sh.6 million.
3. At the end of year 3, the contract was complete. The company spent an accumulated total cost of Sh.60 million.
4. The company recognises long-term contract revenue using the percentage of completion method and estimates the percentage complete based on expenditure incurred as a percentage of total estimated expenditures.

Required:
The amount of revenue that Fairmall Technology Limited should recognise in year 1, year 2 and year 3. (6 marks)

(b) The following comprehensive income statement relates to the performance of Beste Ltd. for the year ended 31 March 2017 and 31 March 2016 respectively:

	31 March 2017 Sh."000"	31 March 2016 Sh."000"
Revenue	141,088	122,516
Cost of sales	(71,956)	(67,400)
Gross profit	69,132	55,116
Distribution costs	(11,054)	(9,830)
Administrative expenses	(29,702)	(22,278)
Total operating profit	28,376	23,008
Profit/(loss) on sale of non-current assets	(1,418)	1,240
Profit before interest and taxation	26,958	24,248
Net interest payable	(5,508)	(6,438)
Profit before taxation	21,450	17,810
Taxation	(6,244)	(4,470)
Profit for the period	15,206	13,340

Required:

(i) Common size percentage income statement for the year ended 31 March 2017 and 31 March 2016. (8 marks)

(ii) Comment on your results in (b)(i) above. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Examine two limitations of cash flow reporting. (2 marks)

(b) The following information relates to Maji Ltd.:

	Sh."000"
Cash and cash equivalents (31 December 2016)	1,500
Cash and cash equivalents (31 December 2017)	1,850
Interest expense	480
Net borrowings	250
Cash dividends	1,250

The corporation tax rate is 30%.

Required:
The free cash flow to the firm (FCFF) at the end of year 2017. (3 marks)

(c) The following are the financial statements for Halzina Limited for the year ended 30 April 2017:

Halzina Limited
Income statement for the year ended 30 April 2017:

	Sh."000"
Revenue	5,106
Cost of sales	(3,628)
Gross profit	1,478
Distribution costs	(250)
Administrative expenses	(528)
Profit from operations	700
Interest received	50
Interest paid	(150)
Profit before tax	600
Income tax expenses	(280)
Profit for the year	320
Dividend payable	200

Halzina Limited
Statement of financial position as at 30 April:

	2017 Sh."000"	2016 Sh."000"
Assets:		
Non-current assets:		
Tangible assets	760	610
Intangible assets	500	400
Investment	-	50
	1,260	1,060
Current assets:		
Inventories	[illegible]00	204
Trade receivables	780	630
Short-term investments	100	-
Cash	4	2
	1,184	836
Total assets	2,444	1,896
Equity and liabilities:		
Equity:		
Ordinary share capital of Sh. 1 each	400	300
Share premium account	320	300
Revaluation reserve	200	182
Retained earnings	320	200
	1,240	982
Non-current liabilities:		
Long-term loan	340	100
Current liabilities:		
Trade payables	254	238
Bank overdraft	170	196
Taxation	240	220
Dividends payable	200	160
	864	814
Total equity and liabilities	2,444	1,896

Additional information:
1. The proceeds of the sale of non-current asset investments amount to Sh.60,000.
2. Fixtures and fittings with an original cost of Sh.170,000 and a carrying value of Sh.90,000 were sold for Sh.64,000 during the year.
3. New fixtures and fittings were purchased at a cost of Sh.402,000.

4. The following information relates to tangible non-current assets:

	30 April 2017 Sh."000"	30 April 2016 Sh."000"
Cost/revaluations	1,440	1,190
Accumulated depreciation	680	580
Carrying value	760	610

5. 100,000 ordinary shares of Sh.1 each were issued during the year at a premium of Sh.0.20 per share.
6. The short-term investments are highly liquid and are close to maturity.

Required:
Statement of cash flows for the year ended 30 April 2017 in accordance with the requirements of International Accounting Standard (IAS) 7: "Statement of cash flows". (15 marks)
(Total: 20 marks)

QUESTION FIVE

(a) Evaluate five mechanisms that could be put in place to prevent strategic manipulation of financial statements. (5 marks)

(b) During the year 2016, OLB Ltd. reported a net income of Sh.115,600 and had 200,000 ordinary shares outstanding for the entire year. The company also had 1,000, 10% Sh.100 par value convertible preferred shares, convertible into 40 ordinary shares each, outstanding for the entire year.
OLB Ltd. also had 600, 7% Sh.1,000 par value convertible bonds, convertible into 100 shares each, outstanding for the entire year. The company also had 10,000 stock options outstanding during the year. Each option is convertible into one share of stock at Sh.15 per share. The average market price of the stock for the year was Sh.20.

The corporate tax rate is 30%.

Required:
The diluted earnings per share (EPS) for OLB Ltd. for the year 2016. (5 marks)

(c) Fahari Ltd. operates a defined benefit pension plan for its employees. On 1 April 2016, the fair value of the pension plan assets was at Sh.8,200,000 and the present value of pension plan liabilities was Sh.8,500,000.
The actuary estimated that the service cost for the year to 31 March 2017 was Sh.2,100,000. The pension plan paid Sh.500,000 to retired members and Fahari Ltd. paid Sh.1,900,000 in contributions to the pension plan in the year to 31 March 2017. The actuary estimated that the relevant discount rate for the year to 31 March 2017 was 6%.

On 31 March 2017, Fahari Ltd. announced improvements to the benefits offered by the pension plan to all of its members. The actuary estimated that the past service cost associated with these improvements was Sh.2 million.
At 31 March 2017, the fair value of the pension plan assets was Sh.10,200,000 and the present value of the pension plan liabilities including the past service cost was Sh.12,500,000.

Required:
In accordance with International Accounting Standard (IAS) 19: "Employee Benefits":

(i) Calculate the net actuarial gain or loss that will be included in Fahari Ltd.'s other comprehensive income for the year ended 31 March 2017. (8 marks)

(ii) Calculate the net pension asset or liability that will be included in Fahari Ltd.'s statement of financial position as at 31 March 2017. (2 marks)
(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 24 November 2016. **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) Analyse six steps that a financial analyst could follow when analysing financial statements of an entity. (6 marks)

(b) The following information was obtained from the records of Faridah Limited for the year ended 31 August 2016:

	Sh."000"
Prior-period adjustment - credit to retained earnings	10,000
Gain on sale of plant assets	42,000
Cost of goods sold	760,000
Income tax expense (savings):	
Continuing operations	64,000
Discontinued operations	16,000
Extraordinary gain	20,000
Preference shares, 8% Sh.100 par value	100,000
Dividends	32,000
Retained earnings, beginning as originally reported	206,000
Treasury stock, common (10,000 shares at cost)	50,000
Selling expenses	156,000
Ordinary shares (90,000 shares issued)	360,000
Sales revenue	1,240,000
Interest expense	60,000
Extraordinary gain	52,000
Income from discontinued operations	40,000
Loss due to lawsuit	22,000
General expenses	124,000

Assume a corporation tax rate of 40%.

Required:

(i) A single-step income statement (with all revenues and gains grouped together) for the year ended 31 August 2016.
Note: Include the earnings per share (EPS) presentation and show computations. Assume no changes in the share prices during the year. (8 marks)

(ii) Statement of retained earnings for the year ended 31 August 2016. (6 marks)
(Total: 20 marks)

QUESTION TWO

(a) Examine three warning signs that might indicate that the financial statements of a company are of a poor quality. (6 marks)

(b) The following financial information relates to Movida Limited for the year ended 30 September 2016:

		Sh."000"
Closing inventories:	Raw materials	150,000
	Work in Progress	60,000
	Finished goods	200,000
Purchases		500,000
Trade accounts receivable		230,000
Trade accounts payable		120,000
Sales		900,000
Cost of goods sold		750,000

Required:
The operating cycle of Movida Limited for the year ended 30 September 2016. (6 marks)

(c) The following balances were obtained from the books of Paloma Limited as at 31 March 2016:

	Debit Sh."000"	Credit Sh."000"
Building	500,000	
Provision for depreciation on building		75,000
Plant at cost	120,000	
Equity shares: (Sh.10 par value)		200,000
Retained earnings (1 April 2015)		375,000
Revaluation reserves		50,000
Interim dividends paid	5,000	
Bank	522,000	
Revenue		873,500
Cost of sales	243,500	
Operating expenses	183,000	
	1,573,500	1,573,500

Additional information:

1. Paloma Limited made a rights issue on 1 October 2015 of 1 share for every 5 shares held at a price of Sh.15 each. The market price per share being Sh.20.
2. A final dividend of 10% to be paid to equity shareholders.
3. A general reserve to be created and Sh.30,000,000 be transferred from retained earnings.

Required:
Statement of changes in equity for the year ended 31 March 2016. (4 marks)

(d) The following information relates to Eagle Limited defined benefit plan for the year ended 31 December 2015:

	Sh."000"
Fair value of plan assets	950
Present value of pension liability	800
Present value of future refunds and reductions in future contributions	70

Required:
The value of the plan assets to be recognised in the financial statements of Eagle Limited for the year ended 31 December 2015. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) Describe four categories of financial instruments as per the International Accounting Standard (IAS) 39 "Financial instruments". (4 marks)

(b) On 1 February 2016, Ndovu Limited acquired 80% of the ordinary share capital of Simba Limited at a cost of Sh.10.28 million. On the same date, Ndovu Limited also acquired 50% of Simba Limited's 10% loan notes at par. The market price of each of the Simba Limited's share at the date of acquisition was Sh.6.

The summarised draft financial statements of both companies are as follows:

Statement of comprehensive income as at 31 October 2016:

	Ndovu Limited Sh."000"	Simba Limited Sh."000"
Revenue	60,000	24,000
Cost of sales	(42,000)	(20,000)
Gross profit	18,000	4,000
Operating expenses	(6,000)	(200)
Loan interest received/(paid)	75	(200)
Profit before tax	12,075	3,600
Taxation	(3,000)	(600)
Profit for the year	9,075	3,000

Statement of financial position as at 31 October 2016:

	Ndovu Limited Sh."000"	Simba Limited Sh."000"
Tangible non-current assets	19,320	8,000
Investment	11,280	-
	30,600	8,000
Current assets	15,000	8,000
Total assets	45,600	16,000
Equity and liabilities:		
Equity:		
Ordinary shares (Sh.1 par value)	10,000	2,000
Retained earnings	25,600	8,400
	35,600	10,400
Non-current liabilities:		
10% loan notes	-	2,000
Current liabilities	10,000	3,600
Total equity and liabilities	45,600	16,000

Additional information:

1. The fair values of Simba Limited's assets were equal to their book values with the exception of its plant which had a fair value of Sh.3,200,000 in excess of its book value at the date of acquisition. The remaining useful life of all Simba Limited's plant at the date of acquisition was four years and this period has not changed as a result of the acquisition.
2. Depreciation of plant is on a straight line basis and is charged to cost of sales. Simba Limited has not adjusted the value of its plant as a result of the fair value exercise.
3. In the past acquisition period, Ndovu Limited sold goods to Simba Limited at a price of Sh.12 million. These goods had cost Ndovu Limited Sh.9 million. During the year, Simba Limited had sold Sh.10 million (at cost to Simba Limited) of these goods for Sh.15 million.
4. Ndovu Limited bears almost all of the administration costs incurred on behalf of the group such as invoicing and credit control. It does not charge Simba Limited for this service as to do so would not have a material effect on the group profit.
5. Revenue and profits should be deemed to accrue evenly throughout the year.
6. The current accounts of the two companies were reconciled at the year end with Simba Limited owing Ndovu Limited Sh.750,000.
7. Ndovu Limited has a policy of valuing non-controlling interest at fair value at the date of acquisition. For this purpose, the share price of Simba Limited should be used.
8. An impairment test on 31 October 2016 showed that consolidated goodwill should be written down by Sh.400,000.

Required:

(i) Consolidated statement of comprehensive income for the year ended 31 October 2016. (8 marks)

(ii) Consolidated statement of financial position as at 31 October 2016. (8 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Discuss four limitations of segment reporting requirements. (4 marks)

(b) For the year ended 31 December 2015, GreatDreams Company Limited reported cash flow from operating activities of Sh.163 million, income from continuing operations of Sh.146 million and total revenue of Sh.852 million. Review of GreatDreams' footnotes revealed the following:

1. In the year 2015, GreatDreams' pension contribution was Sh.35 million higher than in previous year. This typical contribution is not expected to continue in the foreseeable future.
2. Included in the income from continuing operations was Sh.17 million one time non-cash charge. The charge is not deductible for income tax purposes.
3. The corporation tax rate is 30%.

Required:

GreatDreams Company Limited excess cash margin. (4 marks)

(c) Explain three ways in which operating leases could impact on the financial statements. (3 marks)

(d) The following information was obtained from the financial statement notes of Kisumu United Ltd. and Tigania Products Ltd. for the year ended 31 December 2015:

	Item	Kisumu United Ltd.	Tigania Products Ltd
1.	Goodwill	The company amortises goodwill over 20 years.	The company amortises goodwill over 5 years.
2.	Property, plant and equipment	The company uses a straight line depreciation method over the economic lives of the assets which range from 5 to 20 years for buildings.	The company uses an accelerated depreciation method over the economic lives of the assets which range from 5 to 20 years for buildings.
3.	Accounts receivable	The company uses a bad debt allowance of 2% of accounts receivable.	The company uses a bad debt allowance of 5% of accounts receivable.

Required:
By comparing the performance of each company in relation to items 1, 2 and 3 above, identify which company has the higher quality of earnings. (9 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following are the financial statements of Quittet Limited for the year ended 31 October 2015 and 31 October 2016:

Quittet Limited
Cash flow statement for the year ended 31 October:

	2015 Sh."000"	2016 Sh."000"
Cash flow from operating activities:		
Profit before interest and tax	2,293	162
Adjustment for:		
• Investment income	-	(55)
• Finance cost	165	102
• Depreciation	262	369
• Loss on disposal of investments	101	-
• Profit on disposal of plant	(2,502)	(2)
	319	576
Working capital changes:		
Increase in inventories	(709)	(201)
Decrease in receivables	532	256
Increase in payables	727	251
Cash flow from operating activities	869	882
Less: Interest paid	(165)	(102)
Tax paid	(13)	(49)
Net cash flow from operating activities	691	731

	2016 Sh."000"	2015 Sh."000"
Cash flow from investing activities:		
Dividends received	-	55
Proceeds from sale of investments	32	-
Proceeds from sale of plant	1,609	12
Net cash flow from investing activities	1,641	67

	Sh."000"	Sh."000"
Cash flow from financing activities:		
Dividend paid	-	(110)
Borrowings	500	100
Net cash flow from financing activities	500	(10)
Net change in cash and cash equivalent2,832	788	
Cash and cash equivalent at the beginning	910	122
Cash and cash equivalent at the end	3,742	910

The extracts from the income statement and statement of financial position for the same period were as follows:

	2016 Sh."000"	2015 Sh."000"
Revenue	2,201	3,102
Equity and liabilities:		
Ordinary share capital (Sh.1 par value)	100	100
Retained earnings	7,052	4,772
	7,152	4,872
Long term liabilities:		
Borrowings	1,500	1,000
Current liabilities:		
Trade and other payables	1,056	329
	9,708	6,201

Required:
Calculate the following cash flow items:

(i) Cash return. (2 marks)

(ii) Cash return on capital employed ratio. (2 marks)

(iii) Cash flow to operating profit ratio. (2 marks)

(iv) Cash interest cover ratio. (2 marks)

(v) Cash flow per share. (2 marks)

(b) The financial controller of Quittet Limited has been under pressure from his operational director to improve the figures in (a)(i) to (v) above in readiness for the upcoming Annual General Meeting (AGM).

Discuss how this pressure might have influenced the financial statements and the reporting in general. (2 marks)

(c) Ivy Maritim, an investment and financial analyst at Faida Capital Investment Services has prepared the following proforma income statement for PinBall Limited for the year ended 30 September 2016:

	Sh."million"
Net sales	6,000
Cost of goods sold	(2,850)
Gross profit	3,150
Selling, general and administration expenses	(1,780)
Depreciation	(280)
Goodwill amortisation	(25)
Operating income	1,065
Interest expense	(170)
Income before taxes	895
Income tax	(300)
Net income	595
Diluted Earnings per Share (EPS) (Sh.)	2.29
Average shares outstanding (millions)	260
Dividends per Share (DPS) (Sh.)	0.64

Ivy Maritim is interested in forecasting the earnings per share (EPS) for the year 2017 and has made the following assumptions for the year 2017, compared with the year 2016:

1. Unit sales will rise by 7% but prices will remain the same.
2. Synergies from acquisitions will add an additional Sh.200 million to net sales.
3. Gross margin as a percentage of net sales will improve by 1.5%.
4. Selling, general and administration expenses as a percentage of sales will improve by 0.7%.
5. Depreciation expense will rise by 5%.
6. Goodwill amortisation will rise by Sh.10 million.
7. Long-term debt will remain the same.
8. Interest rates will decrease, reducing interest expense by Sh.10 million.
9. The income tax rate will rise by 0.5%.
10. Average shares outstanding will remain the same.
11. Dividends per share (DPS) will rise by 10%.

Required:

Projected income statement for PinBall Limited for the year ended 30 September 2017. (8 marks)

(Total: 20 marks)

KASNEB

CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 26 May 2016. **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) (i) Differentiate between "top down investing" and "bottom up investing" as an approach to analysing financial statements of a firm. (4 marks)

(ii) Outline three limitations of financial analysis. (3 marks)

(b) On 1 January 2013, Dualmax Limited granted 100 cash share appreciation rights (SARs) to each of its 500 employees on condition that the employees remain in its employment for at least the next two years. The SARs vest on 31 December 2014 and could be exercised at any time up to 31 December 2015. The fair value of each SAR at the grant date is Sh.7.40. The following information has also been provided:

Year ended	Leavers	Number of employees exercising rights	Outstanding SARs	Estimated further leavers	Fair value of SARs Sh.	Intrinsic value (cash paid) Sh.
31 December 2013	50	-	450	60	8.00	-
31 December 2014	50	100	300	-	8.50	8.10
31 December 2015	-	300	-	-	-	9.00

Required:
The expense and liability which will appear in the financial statements in each of the three years. (6 marks)

(c) The directors of Zedmark Ltd. have been presented with the following abridged financial statements:

Zedmark Ltd.
Income statement for the year ended 30 September:

		2014		2015
	Sh."000"	Sh."000"	Sh."000"	Sh."000"
Sales revenue		3,600		3,840
Cost of sales:				
Opening inventories	320		400	
Purchases	2,240		2,350	
	2,560		2,750	
Closing inventories	(400)	(2,160)	(500)	(2,250)
Gross profit		1,440		1,590
Expenses		1,360		1,500
Profit		80		90

Zedmark Ltd.
Statement of financial position as at 30 September:

	2014	2015
	Sh."000"	Sh."000"
Non-current assets:		
Property, plant and equipment	1,900	1,860
Current assets:		
Inventories	400	500
Trade receivables	750	960
Cash at bank	8	4
	1,158	1,464
Total assets	3,058	3,324
Equity and liabilities:		
Equity		
Ordinary shares (Sh.1 each)	1,650	1,766
Reserves	1,018	1,108
	2,668	2,874
Current liabilities	390	450
Total equity and liabilities	3,058	3,324

Required:

(i) Calculate three profitability ratios and three efficiency ratios for the years ended 30 September 2014 and 30 September 2015. (6 marks)

(ii) Comment on the profitability and efficiency of the company using the ratios calculated in (c)(i) above. (1 mark)

(Total: 20 marks)

QUESTION TWO

(a) In a recent seminar on the requirements of International Financial Reporting, many investments and financial analysts commented on a growing disillusionment with the usefulness and reliability of the information contained in some companies income statements.

With reference to the above statement, discuss the extent to which a company's statement of cash flow could be more useful and reliable than its income statement. (6 marks)

(b) The following are the comprehensive financial statements of Bozi Limited for the year ended 31 March 2015 and 31 March 2016:

Bozi Limited

Comprehensive income statement for the year ended 31 March 2016:

	Sh."000"
Revenue	5,106
Cost of sales	(3,628)
Gross profit	1,478
Distribution cost	(250)
Administrative expenses	(528)
Profit from operations	700
Interest received	50
Interest paid	(150)
Profit before tax	600
Income tax expense	(280)
Profit for the year	320
Dividend payable	200

Bozi Limited

Statement of financial position as at 31 March:

	2016 Sh."000"	2015 Sh."000"
Assets:		
Non-current assets:		
Tangible assets	760	610
Intangible assets	500	400
Investments	-	50
Current assets:		
Inventories	300	204
Trade receivables	780	630
Short-term investments	100	-
Cash in hand	4	2
Total assets	2,444	1,896
Equity and liabilities:		
Equity:		
Ordinary share capital (Sh.1 par value)	400	300
Share premium	320	300
Revaluation reserves	200	182
Retained earnings	320	200
Non-current liabilities:		
Long-term loan	340	100
Current liabilities:		
Trade payables	254	238
Bank overdraft	170	196
Taxation	240	220
Dividend payable	200	160
Total equity and liabilities	2,444	1,896

Additional information:

1. The proceeds of the sale of non-current assets investments amounted to Sh.60,000.
2. Fixtures and fittings with original cost of Sh.170,000 and a carrying value of Sh.90,000 were sold for Sh.64,000. During the year, new fixtures and fittings were purchased costing Sh.402,000.
3. The following information relates to tangible non-current assets as at 31 December:

	2014 Sh."000"	2015 Sh."000"
Cost/revaluation	1,440	1,190
Accumulated depreciation	680	580
Carrying value	760	610

4. 100,000 Sh.1 ordinary shares were issued during the year at a premium of Sh.0.20 per share.
5. The short-term investments are highly liquid and are close to maturity.

Required:

Bozi Limited Statement of Cash Flows for the year ended 31 March 2016 in accordance with the requirements of International Accounting Standards (IAS) 7 ("Statement of Cash flows"). Use the indirect method. (14 marks)

(Total: 20 marks)

QUESTION THREE

(a) Examine three techniques that could be used in financial model building and forecasting. (3 marks)

(b) On 1 January 2014, Mobizon Limited, a manufacturing company, leased a cast iron making machine for four years. The lease calls for payment of Sh.12 million per year payable at the beginning of the year. At the end of the four years, Mobizon Limited will return the machine to the lessor who will sell it for scrap. The appropriate interest rate is 9%. Mobizon Limited depreciates its assets on a straight line basis.

Required:

Total expense under finance lease to be reported in the income statement for the year ended 31 December 2015. (4 marks)

(c) Apex Limited had 3,600,000 ordinary shares in issue on 1 January 2015. The profit after tax for the year ended 31 December 2015 was Sh.2,700,000.

Additional information:

1. On 1 July 2015, the company made a rights issue at a price of Sh.9.50 per share on the basis of one share for every five shares held. The share price immediately prior to the rights issue had been Sh.12.50 per share.
2. On 1 April 2015, Apex Limited issued Sh.5,000,000 7% convertible bonds at a discount rate of 5% to their par value. The terms of issue provided that the bond can be either redeemed for cash at par value or be converted into ordinary shares on 31 March 2018.
3. Each Sh.10 bond is convertible into two new ordinary shares. The proceeds of the convertible bonds issue have been credited to non-current liabilities.
4. The interest is payable annually in arrears commencing 31 March 2016. The effective rate of interest on an equivalent bond without the option to convert to ordinary shares would be 11% per annum.
5. The earnings per share (EPS) for the year ended 31 December 2014 was Sh.0.8.
6. Assume a corporate tax rate of 30%.

Required:

(i) The initial carrying amount of the convertible bond in both liability and equity component. (4 marks)

(ii) Basic earnings per share (EPS) for the year ended 31 December 2015. (4 marks)

(iii) Adjusted EPS for the year ended 31 December 2014 as it should be disclosed in the year 2015. (1 mark)

(iv) Diluted EPS for the year ended 31 December 2015. (4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) (i) Explain the term "creative accounting" as used in the analysis of financial statements. (1 mark)

(ii) Propose five ways in which creative accounting could take place in an organisation. (5 marks)

(b) On 1 January 2011, A Ltd., a public limited company acquired 60% of B Ltd., a public limited company. On 30 July 2009, A Ltd. had acquired 10% of C Ltd. and on the same day B Ltd. had acquired 80% of C Ltd.

The following are the statements of financial position of the three companies as at 31 December 2015:

	A Ltd. Sh."million"	B Ltd. Sh."million"	C Ltd. Sh."million"
Non-current assets:			
Property, plant and equipment	2,458	1,410	870
Investment in B Ltd.	900		
Investment in C Ltd.	27	240	
	3,385	1,650	870
Current assets:			
Inventories	450	200	260
Trade receivables	610	365	139
Cash	240	95	116
	1,300	660	515
	4,685	2,310	1,385
Equity:			
Ordinary share capital	500	200	100
Share premium	250	120	50
Retained earnings	2,805	1,572	850
	3,555	1,892	1,000
Current liabilities:			
Trade payables	1,130	418	385
	4,685	2,310	1,385

Additional information:

1. During the year ended 31 December 2015, B Ltd. sold goods to C Ltd. for Sh.260 million including a mark up of 25%. All of these goods remained in the inventories at the year end.
2. The retained earnings of the three companies at the acquisition dates was as follows:

	30 July 2009 Sh."million"	1 January 2011 Sh."million"
A Ltd.	1,610	1,860
B Ltd.	700	950
C Ltd.	40	100

3. The book values of the identifiable net assets at the acquisition date are equivalent to their fair values.
4. On 1 January 2011, the fair value of A Ltd. was 10% holding and in C Ltd. was Sh.50 million.
5. A Ltd. and B Ltd. hold their investment in subsidiaries at cost in their separate financial statements. It is group policy to value the non controlling interests at fair value at acquisition. The directors valued the non controlling interests in B Ltd. at Sh.536 million and C Ltd. at Sh.210 million on 1 January 2011.
6. No impairment losses have been necessary in the consolidated financial statements to date.

Required:

Group consolidated statement of financial position as at 31 December 2015. (14 marks)

(Total: 20 marks)

QUESTION FIVE

(a) On 1 July 2013, Quorondom Limited issued a redeemable debt instrument at a par value of Sh.6 million. The instrument carries a fixed coupon interest at a rate of 6% payable annually in arrears. The debt instrument will be redeemable for Sh.6.02 million on 30 June 2017. Transaction costs associated with the issue were Sh.200,000 and were paid at the time of the issue. The approximate interest rate applicable to this liability is 7.06%.

Required:

The carrying value of the liability to be included in Quorondom Limited in the statement of financial position as at 30 June 2015.

Note: (Round all workings to the nearest Sh."000"). (3 marks)

(b) Kesty Ltd. made taxable trading profits of Sh.1,200,000 for the year ended 30 April 2016 on which corporation tax is payable at a rate of 30%. A transfer of Sh.20,000 will be made to the deferred taxation account. The balance on this account was Sh.100,000 before making any adjustments for the following items:

1. The estimated tax on profits for the year ended 30 April 2015 was Sh.80,000 but tax has been agreed at Sh.84,000 and fully paid.

2. Tax on profits for the year to 30 April 2016 is payable in arrears.

3. In the year to 30 April 2016, the company made a capital gain of Sh.60,000 on the sale of some property.

The capital gain is taxable at a rate of 30%.

Required:

(i) The tax charge for the year to 30 April 2016. (4 marks)

(ii) The tax liabilities in the statement of financial position. (4 marks)

(c) (i) Explain the three components of DuPont equation. (6 marks)

(ii) An investment and financial analyst gathered the following information about Farasi Holdings Limited for the year ended 31 December 2015:

	Sh."000"
Revenue	1,000
Net income	400
Total assets	500
Shareholders' equity	10,000

Required:

The company's return on equity (ROE) using DuPont analysis. (3 marks)

(Total: 20 marks)

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Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	9804	9709	9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	8772	8696	.8621	.8475	.8333	.8065	.7813	7576	7353
2	.9803	.9612	.9426	9246	9070	8900	8734	.8573	.8417	.8264	.7972	7695	7561	.7432	.7182	.6944	.6504	.6104	5739	.5407
3	9706	.9423	.9151	8890	.8638	.8396	.8163	7938	7722	.7513	7118	6750	6575	.6407	.6086	.5787	.5245	.4768	4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	6499	.6209	.5674	5194	4972	.4761	.4371	.4019	.3411	2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	4104	.3704	.3349	.2751	.2274	1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	3555	.3186	.2567	.2076	.1869	1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	3152	2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	1069	.0930	.0708	.0541	.0320	.0193	.0118	0073
17	8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	0703	.0596	.0431	0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	4776	.3751	.2953	.2330	.1842	.1460	1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	3066	.2083	.1420	.0972	.0668	0460	.0318	.0221	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1-\frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 26 November 2015. **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) Explain three components of management commentary in a company's annual report to shareholders. (6 marks)

(b) The auditors of Global Meridian Investment Limited discovered that certain items had been included in the inventory of the company as at 31 October 2015. These items which were valued at Sh.4.2 million had in fact been sold before the end of the year.

The following are the extracts of the income statements of Global Meridian Investment Limited for the year ended 31 October 2014 and 31 October 2015:

Statement of comprehensive income for the year ended 31 October:

	2014 Sh. "000"	2015 Sh. "000"
Revenue	47,400	67,200
Cost of goods sold	(34,570)	(55,800)
Profit before tax	12,830	11,400
Income tax expense	(3,880)	(3,400)
Net profit	8,950	8,000

Additional information:

1. The retained profits as at 1 November 2013 amounted to Sh.13 million.
2. The cost of goods sold for the year ended 31 October 2015 includes an error of Sh.4.2 million in the opening inventory.
3. The corporation income tax rate for 2014 and 2015 was 30%.

Required:

(i) Comparative income statement for the year ended 31 October 2015. (6 marks)

(ii) Retained earnings for the year ended 31 October 2015. (4 marks)

(c) During the financial year ended 31 October 2010, Walnut Ltd. issued the following two financial instruments:

1. Redeemable preference shares with a coupon rate of 8%. The shares are redeemable on 31 October 2016 at a premium of 10%.
2. A grant of share options to senior executives. The options may be exercised from 31 October 2015.

Required:

For each of the instruments, identify whether it should be classified as debt or equity. Justify your choice citing the relevant provision of International Accounting Standards or International Financial Reporting Standards. (4 marks)

(Total: 20 marks)

QUESTION TWO

One of your clients, Best Limited, invested in 50% of the ordinary share capital of Fist Limited several years ago. The management has presented you with the following financial statements of the two companies for the year ended 31 May 2015:

Income statement for year ended 31 May 2015:

	Best Limited Sh. "million"	Fist Limited Sh. "million"
Revenue	10,500	8,600
Cost of sales	(4,200)	(3,100)
Gross profit	6,300	5,500

	Sh. "million"	Sh. "million"
Expenses:		
Distribution costs	(1,400)	(2,000)
Administrative expenses	(1,050)	(2,980)
Finance cost	(200)	(100)
Profit before tax	3,650	420
Income tax expense	(1,050)	(120)
Profit for the period	2,600	300
Dividends paid	(500)	-
Profit for the year	2,100	300
Retained profits brought forward	1,400	1,000
Retained profits carried forward	3,500	1,300

Statement of financial position as at 31 May 2015:

	Best Limited Sh. "million"	Fist Limited Sh. "million"
Non-current assets		
Property, plant and equipment	5,000	2,100
Investment in Fist Limited	450	-
Other investments	300	200
	5,750	2,300
Current assets		
Inventory	2,650	350
Trade receivables	1,200	650
Cash at bank	600	200
	4,450	1,200
Total assets	10,200	3,500
Equity and liabilities		
Equity		
Ordinary share capital	4,000	500
Retained profits	3,500	1,300
Shareholders' funds	7,500	1,800
Non-current liabilities		
10% loan stock	2,000	1,000
Current liabilities		
Trade payables	650	600
Current tax	50	100
	700	700
Total equity and liabilities	10,200	3,500

Additional information:

1. Best Limited acquired Fist Limited when the retained profits of Fist Limited amounted to Sh.300 million. There was no fair value adjustments.
2. During the year, the inter-company sales between Best Limited and Fist Limited amounted to Sh.200 million. None of these goods were remaining in the inventory.
3. As at 31 May 2015, Best Limited owed Fist Limited Sh.40 million.
4. Goodwill arising on the acquisition of Fist Limited has not been impaired in the past but in the current year, the management of Best Limited feels there should be a 20% impairment.

Required:

(a) Prepare in columnar form, the financial statements of Best Limited assuming that the investment in Fist Limited should be accounted for using:

(i) Proportional consolidation method. (6 marks)

(ii) Equity method. (6 marks)

(b) Compute the following ratios for each of the methods identified in (a) (i) and (ii) above:

(i) Net profit margin. (2 marks)

(ii) Return on equity. (2 marks)

(iii) Gearing ratio. (2 marks)

(c) Comment on the results obtained in (b) (i) to (iii) above. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Outline four applications of financial statements forecasting. (4 marks)

(b) The following financial statements relate to Alpha Limited and Omega Limited for the year ended 31 October 2015:

	Alpha Limited		Omega Limited	
	Sh. "million"	Sh. "million"	Sh. "million"	Sh. "million"
Sales		4,000		6,000
Cost of sales				
Opening inventory	200		800	
Purchases	3,200		4,800	
	3,400		5,600	
Closing inventory	(400)	(3,000)	(800)	(4,800)
Gross profit		1,000		1,200
Expenses				
Distribution Costs	200		150	
Administrative expenses	290		250	
Finance cost	10	(500)	400	(800)
Profit before tax		500		400
Income tax expense		(120)		(90)
Profit after tax		380		310
Dividends paid		(150)		(100)
Retained profit for the year		230		210
Retained profit brought forward		220		2,480
Retained profit carried forward		450		2,690

Statement of financial position as at 31 October 2015:

	Alpha Limited		Omega Limited	
	Sh. "million"	Sh. "million"	Sh. "million"	Sh. "million"
Non-current assets				
Land and Buildings	1,200		5,000	
Furniture and motor vehicle	600	1,800	1,000	6,000
Current assets				
Inventory	400		800	
Trade receivables	850		750	
Financial assets	100		230	
Cash at bank	-	1,350	100	1,880
Total assets		3,150		7,880
Equity and liabilities				
Equity				
Ordinary shares		1,000		1,600
Retained profits		450		2,690
		1,450		4,290
Non-current liabilities				
Bank loans		500		3,000
Current liabilities				
Trade payables	1,080		590	
Bank overdraft	120	1,200	-	590
		3,150		7,880

Required:

(i) Common size percentage income statement for the year ended 31 October 2015. (7 marks)

(ii) Common size percentage statement of financial position as at 31 October 2015. (7 marks)

(iii) Comment on the profitability and gearing of the two companies based on the results obtained in (b) (i) and (ii) above. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Outline four factors that could be considered in determining an entity's functional currency as per International Accounting Standard, IAS 21 - The effects of changes in foreign exchange rates. (4 marks)

(b) ABC Ltd. formed a subsidiary in a foreign country on 1 January 2014 through a combination of debt and equity financing. The foreign subsidiary acquired land on 1 January 2014 which it rents to a local farmer. The foreign subsidiary's financial statements for its first year of operations, in foreign currency units (FC), are as follows:

Foreign subsidiary statement of comprehensive income:

	2014 FC (million)
Rent revenue	1,000
Interest expense	(250)
Net income	750

Foreign subsidiary statement of financial position:

	1 January 2014 FC (million)	**31 December 2014 FC (million)**
Cash	1,000	1,750
Land	9,000	9,000
Total assets	10,000	10,750
5% notes payable	5,000	5,000
Ordinary share capital	5,000	5,000
Retained earnings	-	750
Total equity and liabilities	10,000	10,750

Additional information:

1. The foreign country experienced significant inflation in 2014, especially in the second half of the year. The general price index during 2014 was as follows:

1 January 2014	100
Average 2014	125
31 December 2014	200

2. The rate of inflation in 2014 was 100% and the foreign country clearly meets the definition of a highly inflationary economy under International Financial Reporting Standards, IFRSs.

3. As a result of the high rate of inflation in the foreign country, the FC weakened substantially during the year relative to other currencies. Relevant exchange rates between ABC Ltd's presentation currency, Kenya Shilling (KES) and the FC during 2014 were as follows:

	KES per FC
1 January 2014	1.00
Average 2014	0.80
31 December 2014	0.50

Required:

The amounts that ABC Ltd. will include in its consolidated financial statements for the year ended 31 December 2014 related to the foreign subsidiary. (8 marks)

(c) The following financial data was extracted from the books of Signtex Limited for the year ended 31 December 2014:

	Sh. "000"
Current tax liability brought forward from the year 2013	102,300
Liability agreed during the year 2014	107,340
Estimated tax liability for year 2014	123,675
Deferred tax liability brought forward from the year 2013	82,254
Tax written down value of non-current assets	2,420,580
Carrying value of non-current assets	2,742,840

The corporation tax rate is 30%

Required:

(i) The taxation charge to be included in the income statement for the year ended 31 December 2014. (6 marks)

(ii) The amounts to be reported on the statement of financial position at the end of the year 2014, indicating how these amounts should be reported. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Identity five warnings signs that might alert financial analysts and investors of low quality revenue reporting. (5 marks)

(b) The following information relates to Athi Limited:

1. The company contributes Sh.42 million per annum to a pension scheme and treats the amount as current service cost pension expense.
2. On 1 July 2015, the actuarial valuation of the scheme showed a deficit of Sh.840 million.
3. The actuary recommended that the deficit be cleared within 4 years by paying Sh.210 million per annum in addition to the annual service costs.
4. The average remaining service years of the employees in the scheme on 1 July 2015 was 8 years.

Required:

For each of the remaining 8 years, calculate the pension expense and the pension liability or assets. (5 marks)

(c) The following summarised information is available in relation to Flamingo Ltd., a publicly listed company:

Income statement extract for the years ended 31 March:

	2015		**2014**	
	Continuing Operations Sh. "000"	**Discontinued Operations Sh. "000"**	**Continuing Operations Sh. "000"**	**Discontinued Operations Sh. "000"**
Profit after tax:				
• Existing operations	2,000	(750)	1,750	600
• Operations acquired on 1 August 2013	450		nil	

Additional information:

1. Analysts expects profits from the market sector in which Flamingo Ltd. existing operations are based to increase by 6% in the year to 31 March 2016 and by 8% in the sector of its newly acquired operations.
2. On 1 April 2013, Flamingo Ltd. had the following financial instruments:
   - Sh.6 million Sh.0.5 equity shares in issue.
   - Sh.5 million 8% convertible loan stock redeemable in the year 2020: the terms of conversion are 40 equity shares in exchange for each Sh.100 of loan stock.
3. On 1 October 2014, the directors of Flamingo Ltd. were granted option to buy 2 million shares in the company for Sh.15 each. The average market price of Flamingo Ltd. shares for the year ending 31 March 2015 was Sh.30 each.
4. Assume a corporation tax rate of 30%.

Required:

(i) Estimated profit after tax for the year ending 31 March 2016. Assuming the analysts expectations prove correct. (2 marks)

(ii) Basic and diluted earnings per shares (EPS) on the continuing operations of Flamingo Ltd. for the year ended 31 March 2015 and the comparatives for the year 2014. (8 marks)

(Total: 20 marks)

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FINANCIAL STATEMENTS ANALYSIS — **CSIA PART II SECTION 3**

THURSDAY: 28 May 2015. — 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) Examine four macro-environment factors that could be considered when analysing the financial statements of a firm. (8 marks)

(b) The following income statement relates to Helex Limited and its investment companies; Shalova Limited and Alpha Limited for the year ended 31 March 2015:

	Helex Limited Sh."million"	Shalova Limited Sh."million"	Alpha Limited Sh."million"
Revenue	700	500	300
Cost of sales	(300)	(150)	(100)
Gross profit	400	350	200
Investment income: Dividends - Shalova Limited	40	-	-
Alpha Limited	16	-	-
	456	350	200
Distribution costs	(100)	(60)	(50)
Administrative expenses	(150)	(80)	(40)
Finance cost	(50)	(20)	(10)
Profit before tax	156	190	100
Income tax expense	(50)	(80)	(30)
Profit after tax for the period	106	110	70
Number of ordinary shares	100 million	50 million	50 million
Dividends paid (Sh.)	50 million	50 million	40 million
Shareholding of Helex Limited	-	80%	40%

Required:

(i) Group consolidated income statement for the year ended 31 March 2015. (10 marks)

(ii) Earnings per share (EPS) for each company and the group. (2 marks)

(Total: 20 marks)

QUESTION TWO

The following trial balance relates to Quantum Limited as at 31 March 2015:

	Sh."000"	Sh."000"
Investment at fair value (1 April 2014)	10,000	
Inventory (1 April 2014)	47,400	
Retained earnings (1 April 2014)		11,940
Accounts receivable	36,000	
Capital redemption reserve		10,000
Provision for depreciation on plant and machinery		48,000
Salaries and wages	23,500	
Assessment rates	180	
Purchases	123,300	
Share premium		5,000
Plant and machinery at cost	110,000	
Cash and bank balances	1,260	
General reserves		27,000
Financial assets available for sale (1 April 2014)	15,000	
Ordinary share capital		100,000
10% redeemable preference shares		40,000
Administrative expenses	14,300	
Instalment tax paid	7,200	
Accounts payable		20,000
Allowance for doubtful debts (1 April 2014)		2,400
Land at cost	102,000	
Sales		210,800
7% debentures		20,000
Interim dividend on ordinary shares paid	5,000	
	495,140	495,140

Additional information:

1. Inventory as at 31 March 2015 was valued at Sh.49,840,000.
2. The allowance for doubtful debts is to be adjusted to 5% of the outstanding accounts receivables as at 31 March 2015.
3. The fair value of investments and finance assets available for sale as at 31 March 2015 was Sh.11,000,000 and Sh.17,500,000 respectively.
4. The following dividends were received during the year ended 31 March 2015:

	Sh."000"
• On investment at fair value	750
• On financial assets available for sale	900

5. Sh.3,000,000 is to be transferred to the general reserves.
6. Provision is to be made for the following:
   - Annual preference dividend and a final dividend of 6% on ordinary shares.
   - Depreciation on plant and machinery at 15% per annum on straight line basis.
   - Interest on debentures.
   - Directors remuneration of Sh.1,250,000.
   - Auditors remuneration of Sh.360,000.
   - Income tax expense of Sh.11,200,000.

Required:

(a) Statement of comprehensive income for the year ended 31 March 2015. (8 marks)

(b) Statement of changes in equity as at 31 March 2015. (4 marks)

(c) Statement of financial position as at 31 March 2015. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) Propose four reasons why companies might consider maintaining off-balance sheet transactions in their financial statements. (4 marks)

(b) On 1 January 2013, Finix Limited purchased a plant for Sh.44 million. The plant is being depreciated over a period of 8 years using straight line basis with no residual value. For tax purposes, the annual depreciation allowance rate is 20% on cost.

On 1 January 2014, Finix Limited revalued the plant upwards by Sh.7 million, however this did not affect its useful life.

Assume a corporation tax rate of 30%.

Required:

(i) The deferred tax movement for the year ended 31 December 2014. (7 marks)

(ii) Deferred tax balance as at 31 December 2014 in accordance with the International Accounting Standard, (IAS) 12 "Income taxes". (2 marks)

(c) You are an equity analyst at Fine Bridge Investment firm. You have been provided with the following summarised data for three companies:

	EXE Limited Sh."million"	WYE Limited Sh."million"	ZED Limited Sh."million"
Revenue	1,752	1,136	2,316
Cost of sales	1,488	1,182	1,890
Profit (loss) after tax	106	(46)	328
Non-current assets	3,220	500	1,820
Current assets	1,084	668	546
Equity	2,138	560	2,280

Required:

(i) The return on equity (ROE) for each company (3 marks)

(ii) The decomposed return on equity (ROE) for each company as a component of profitability, efficiency and leverage. (4 marks)

(Total: 20 marks)

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QUESTION FOUR

(a) ABC Limited operates a defined benefit plan. During the year ended 31 December 2014, the company had the following information regarding the plan:

	Sh."million"
Present value of obligation as at 1 January 2014	800
Fair value of plan assets as at 1 January 2014	500
Interest rate for obligation	10%
Interest rate for expected returns	6%
Current service cost	100
Benefits paid	50

Required:

(i) Determine the profit or loss items, the statement of changes in equity items and statement of financial position items if the obligation and plan assets are Sh.1,000 million and Sh.730 million respectively as at 31 December 2014. (6 marks)

(ii) Using suitable computations, explain how the items identified in (a) (i) above would be affected if the interest rate for obligation is reduced to 8%. (6 marks)

(b) The profit after tax for Amitel Ltd. for the year ended 31 December 2014 was Sh.15 million. At 1 January 2014, the company had in issue 36 million ordinary shares and a Sh.10 million, 8% convertible debenture. The debenture will mature in 2016 and will be redeemed at par or converted to ordinary shares on the basis of 25 shares for each Sh.100 of debenture held at debenture holder's option. On 1 April 2014, Amitel Ltd. made a fully subscribed rights issue of one new share for every four shares held at a price of Sh.2.80 each. The market price of the ordinary shares of Amitel Ltd. immediately before the issue was Sh.3.80 per share.

Amitel has an income tax rate of 30%.

Required:

(i) The basic earnings per share (EPS) for the year ended 31 December 2014. (5 marks)

(ii) The diluted earnings per share (EPS) for the year ended 31 December 2014. (3 marks)

(Total: 20 marks)

QUESTION FIVE

(a) In accordance with International Financial Reporting Standards (IFRS), 5 "Non-current assets held for sale and discontinued operations":

(i) Define the term "discontinued operation". (2 marks)

(ii) Explain two reasons why the disclosure of discontinued operations could be important to users of financial statements. (2 marks)

(b) Outline four types of investment properties as per the International Accounting Standard (IAS) 40 "Investment property". (4 marks)

(c) The following is the segment information for Dimac Limited for the year ended 31 March 2015:

	Software Sh."million"	Electronics Sh."million"	Engineering Sh."million"	Total Sh."million"
Revenue from external customers	360	210	85	655
Intersegment revenues	95	40	-	135
Interest revenue	34	-	-	34
Interest expense	-	28	8	36
Depreciation	80	55	15	150
Reportable segment profit	20	24	18	62
Other material non-cash items:				
Impairment of assets	-	39	-	39
Reportable segment assets	170	125	44	339
Expenditure for reportable segment:				
Non-current assets	28	23	26	77
Reportable segment liabilities	85	67	22	174

Required:

(i) Analyse the performance of each of the three business segments for the year ended 31 March 2015. (10 marks)

(ii) Comment on the results obtained in (c) (i) above. (2 marks)

(Total: 20 marks)

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THURSDAY: 4 December 2014. 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) Outline five contents of the notes that accompany the financial statements of a company. (5 marks)

(b) Outline five criteria to be satisfied before revenue from sale of goods could be recognised as per the International Accounting Standard (IAS) 18 "Revenue". (5 marks)

(c) The following information relates to ABC Limited for the year ended 31 December 2013:

1. Sh.3,500,000 net income.
2. 500,000 outstanding ordinary shares.
3. 40,000 outstanding convertible preference shares.
4. The company has no other potentially dilutive securities.
5. The company pays a preference dividend of Sh.10 per share.
6. Each preference share is convertible into five ordinary shares of the company.

Required:

(i) Basic earnings per share (EPS). (3 marks)

(ii) Diluted earnings per share (EPS). (3 marks)

(iii) Distinguish between "dilutive securities" and "antidilutive securities". (4 marks)

(Total: 20 marks)

QUESTION TWO

The following financial statements were extracted from the books of Bemu Limited for the years ended 31 March 2013 and 31 March 2014:

Statement of comprehensive income for the year ended 31 March:

	2014 Sh. "000"	2013 Sh. "000"
Revenue	31,000	25,000
Cost of sales	(21,800)	(18,600)
Gross profit	9,200	6,400
Distribution costs	(3,600)	(2,400)
Administrative expenses	(2,200)	(1,600)
Finance costs: loan interest	(150)	(250)
lease interest	(250)	(100)
Profit before tax	3,000	2,050
Income tax expense	(1,000)	(750)
Profit for the year	2,000	1,300
Other comprehensive income (note 1)	1,350	–
	3,350	1,300

Statement of financial position as at 31 March:

	2014 Sh. "000"	2014 Sh. "000"	2013 Sh. "000"	2013 Sh. "000"
Assets				
Non-current assets:				
Property, plant and equipment		14,000		10,700
Deferred development expenditure		1,000		–
		15,000		10,700
Current assets:				
Inventory	3,300		3,800	
Trade receivables	2,950		2,200	
Bank	50	6,300	1,300	7,300
Total assets		21,300		18,000
Equity and liabilities:				
Equity:				
Equity shares (Sh. 1 each)		8,000		8,000
Revaluation reserve		1,350		
Retained earnings		3,200		1,750
		12,550		9,750
Non-current liabilities:				
5% loan notes	1,400		3,125	
Deferred tax	1,500		800	
Finance lease obligation	1,200	4,100	900	4,825
Current liabilities:				
Finance lease obligation	750		600	
Trade payables	2,650		2,100	
Current tax payable	1,250	4,650	725	3,425
Total equity and liabilities		21,300		18,000

Additional information:

1. Bemu Limited acquired an additional plant with a fair value of Sh.1.5 million through a finance lease on 1 July 2013.
2. Bemu Limited revalued property upwards by Sh.2 million and transferred Sh.650,000 of the revaluation amount to deferred tax on 1 July 2013.
3. There was no disposal of non-current assets during the period.
4. Depreciation of property, plant and equipment was Sh.900,000 for the year ended 31 March 2014.
5. Amortisation of the deferred development expenditure was Sh.200,000 for the year ended 31 March 2014.

Required:

Statement of cash flows for Bemu Limited for the year ended 31 March 2014 in accordance with the International Accounting Standard (IAS) 7 (statement of cash flows). Use the indirect method. (Total: 20 marks)

QUESTION THREE

(a) In the context of International Accounting Standard (IAS) 10 "Events after the reporting period":

(i) Define the period to which IAS 10 relates. (1 mark)

(ii) Distinguish between "adjusting event" and "non-adjusting event". (4 marks)

(b) On 1 January 2014, ABC Ltd. made an investment in a financial instrument at its nominal value of Sh.2,000,000.

Additional information:

1. The financial instrument carries a fixed coupon interest rate of 7% per annum receivable annually in arrears.
2. On acquisition, ABC Ltd. paid Sh.50,000 as the transaction cost.
3. The financial instrument will be redeemed for Sh.2,265,000 on 31 December 2017.
4. The effective interest rate applicable to this financial instrument has been calculated at 8.4%.
5. ABC Ltd. intends to hold this investment until its redemption date.

Required:

In accordance with International Accounting Standard (IAS) 32 "Financial Instruments: Presentation" and International Accounting Standard (IAS) 39 "Financial Instruments: Recognition and Measurement":

(i) Explain how this investment should be classified. (2 marks)

(ii) Determine the carrying value of the investment to be included in the statement of financial position of ABC Ltd. as at 31 December 2014. (4 marks)

(c) In the context of International Accounting Standard (IAS) 12 "Income taxes":

(i) Distinguish between "temporary differences" and "permanent differences". (4 marks)

(ii) Maporomoko Ltd. has recently revalued one of its depreciable properties and estimated that its remaining useful life would be another 20 years. The applicable tax rate for all years is 30% and the revaluation of the property is not recognised for tax purposes. Details related to the asset are provided below:

	Accounting purpose Sh. "000"	Tax purpose Sh. "000"
Original values and estimates (1 January 2011):		
Acquisition cost in 2011	8,000	8,000
Depreciation (straight line method)	20 years	8 years
Accumulated depreciation (31 December 2013)	1,200	3,000
Net balance (31 December 2013)	6,800	5,000
Revaluation and estimate (1 January 2014):		
Revaluation balance (1 January 2014)	10,000	Not applicable
New estimated life	20 years	

Required:

The deferred tax liability as at 31 December 2014. (5 marks)

(Total: 20 marks)

QUESTION FOUR

(a) You are the financial analyst of Papinet Securities Limited. Your portfolio manager has provided you with the following data for Growers Limited and the industry average:

Ratio	2011	2012	2013	2013 Industry average
Long-term debt	0.35	0.40	0.45	0.35
Inventory turnover	32.25	42.42	62.65	53.25
Depreciation/Total Assets	0.018	0.014	0.25	0.015
Days' sales in receivables	94	98	113	130.25
Debt to equity	0.90	0.85	0.75	0.88
Profit margin	0.06	0.07	0.082	0.075
Total assets turnover	0.70	0.65	0.54	0.40
Quick ratio	1.029	1.03	1.028	1.031
Times interest earned	4.45	4.375	0.90	4.65
Equity multiplier	1.90	1.85	1.75	1.88
Current ratio	1.15	1.21	1.33	1.25

Required:

(i) In the annual report to the shareholders, the Chief Executive Officer (CEO) of Growers Limited wrote "2013 was a good year for the firm with respect to our ability to meet our short-term obligations. We had higher liquidity largely due to an increase in highly liquid current assets (cash, account receivables and short-term marketable securities)".

Comment on the Chief Executive Officer's statement using only relevant information in your analysis. (4 marks)

(ii) Comment on the firm's asset management. Be as elaborate as possible using relevant information provided. (4 marks)

(iii) Provide the shareholders of Growers Limited with an assessment of the firm's solvency and leverage. (4 marks)

(b) The following financial statements were obtained from the financial records of Simphex Limited for the years ended 31 October 2013 and 31 October 2014:

Income statement for the year ended 31 October:

	2014 Sh. "000"	2013 Sh. "000"
Revenue	2,875	2,625
Cost of sales	(1,500)	(1,287.5)
Gross profit	1,375	1,337.5
Other income	100	62.5
Distribution cost	(150)	(125)
Administrative expenses	(537.5)	(500)
Finance cost	(100)	(90)
Profit before tax	687.5	685
Income tax expense	(287.5)	(275)
Profit after tax	400	410
Preference dividends	(35)	(35)
Ordinary dividends	(62.5)	(62.5)
Retained profit for the year	302.5	312.5
Retained profit brought forward	1,350	1,037.5
Retained profit carried forward	1,652.5	1,350

Required:

Horizontal analysis income statement for the year ended 31 October 2014. (8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) "Creative accounting is the transformation of the financial accounting figures from what they actually are to what preparers desire by taking advantage of the existing rules and/or ignoring some or all of them" Kamal Nasir, 1993:2

In light of the above statement, outline four reasons why directors of listed companies could seek to use creative accounting. (4 marks)

(b) Azep Ltd. acquired 80% of the ordinary share capital of Boxx Ltd. on 1 January 2013 for Sh.800 million. The group's policy is to value non-controlling interest at fair value at the date of acquisition. On 1 January 2013, the non-controlling interest of Boxx Ltd. had a fair value of Sh.200 million. Boxx Ltd. acquired 60% of the ordinary share capital of Camphor Ltd. on 1 January 2014 for Sh.480 million.

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As at 1 January 2014, the fair value of the non-controlling interest in Camphor Ltd. included in the consolidated financial statements of Azep Ltd. was Sh.280 million.

The fair value of the net assets of the acquired entities was as follows:

	1 January 2014 Sh. "million"	1 January 2013 Sh. "million"
Net assets of Boxx Ltd.	977	940
Net assets of Camphor Ltd.	620	570

Additional information:

1. The fair value of the net assets of Boxx Ltd. and Camphor Ltd. at their dates of acquisition by Azep Ltd. were deemed to be the same as their book values.
2. There has been no impairment to goodwill since the acquisition dates.
3. In the year ended 30 September 2014, all the three entities paid a dividend to their ordinary shareholders. Azep Ltd. paid a dividend of Sh.80 million, Boxx Ltd. Sh.50 million and Camphor Ltd. Sh.20 million.

The income statements for the year ended 30 September 2014 are as provided below:

	Azep Ltd. Sh. "million"	Boxx Ltd. Sh. "million"	Camphor Ltd. Sh. "million"
Revenue	1,000	600	400
Cost of sales	(700)	(400)	(200)
Gross profit	300	200	200
Operating expenses	(120)	(80)	(100)
Net operating income	180	120	100
Investment income (Note 3)	50	12	-
Profit before tax	230	132	100
Income tax expense	(70)	(45)	(30)
Profit for the year	160	87	70

Required:

(i) Consolidated income statement for the year ended 30 September 2014. (10 marks)

(ii) The value of goodwill that will appear in the consolidated statement of financial position of the Azep group as at 30 September 2014. (6 marks)

(Total: 20 marks)

KASNEB

CSIA PART II SECTION

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 29 May 2014. 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) (i) Briefly explain the term "triple bottom line reporting". (2 marks)

(ii) Outline two advantages of triple bottom line reporting. (4 marks)

(b) During the year ended 31 December 2013, Wananchi Limited reported an operating profit before tax of Sh.2 million but after charging Sh.4 million being the cost of developing and launching a new product which was expected to generate profits for four years.

Additional information:

1. Corporation tax rate is 30%.
2. The company has a risk adjusted weighted average cost of capital (WACC) of 12% per annum.
3. The company pays interest at the rate of 9% per annum on a loan.
4. The value of the company's non-current assets is Sh.50 million.
5. The value of the net current assets is Sh.22 million.
6. The replacement cost of the non-current assets is estimated at Sh.64 million.

Required:

Compute for the year ended 31 December 2013:

(i) The company's economic value added (EVA). (3 marks)

(ii) The company's residual income. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) Examine six steps that a securities and investment analyst is expected to follow when undertaking financial statements analysis. (6 marks)

(b) Agnes Chebii has obtained the published financial statements of several quoted companies in which she is considering buying some shares as a personal investment. She has presented you with the following information on two such companies:

1. In the year ended 31 December 2013, two companies, Diamond Investment Ltd. and Uranium Investment Ltd. reported identical before tax profits of Sh.200 million. Information in the respective Chairmen's reports indicated that both companies were expecting profits from their core activities operations (to be interpreted as from continuing operations) to grow by 10% in the year 2014.
2. An extract of the income statements of the two companies is shown below:

	Diamond Investment Ltd. Sh. "million"	Uranium Investment Ltd. Sh. "million"
Operating profit:		
Continuing activities	140	180
Acquisitions	Nil	100
Discontinued activities	60	(80)
	200	200

3. A note to the financial statements of Uranium Investment Ltd. indicated that the discontinuation occurred on 1 July 2013 and was part of an overall plan on its traditional core activities after incurring huge losses on a new foreign venture.

Required:

(i) Explain to Agnes Chebii three reasons why information on discontinued operations is useful. (3 marks)

(ii) Calculate the expected operating profits for both companies for the year ending 31 December 2014. (Assume the Chairmen's growth forecast is correct). (3marks)

(iii) Advise Agnes Chebii on which of the two companies she should invest in. (1 mark)

(c) Peter Maoke, a securities and investment analyst at Zentex Investment Bank has gathered the following data regarding Investek Ltd. for the year ended 31 December 2013:

1. The company had 1,000,000 outstanding ordinary shares. No change was made during the year.
2. The net income for the year was Sh.5 million.
3. The company paid Sh.500,000 preference dividends and Sh.600,000 ordinary dividends during the year.
4. The average market price of the ordinary shares is Sh.60.
5. The company has 100,000 warrants (for 1 share each) outstanding that are exercisable at Sh.50.

Required:

The diluted earnings per share (EPS) for the year ended 31 December 2013. (7 marks)

(Total: 20 marks)

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QUESTION THREE

The following trial balance was extracted from the books of Evalex Technologies Ltd. as at 31 March 2014:

	Sh. '000'	Sh. '000'
Ordinary share capital (Sh.10 each)		56,000
Retained profit (1 April 2013)		1,400
8% convertible debenture		30,000
Land (cost)	25,000	
Building (cost)	50,000	
Plant and equipment (cost)	74,500	
Accumulated depreciation (1 April 2013)		
- Building		10,000
- Plant and equipment		24,500
Current tax		800
Deferred tax		2,600
Inventory (31 March 2014)	36,000	
Trade receivables	47,100	
Bank loan		11,500
Trade payables		24,500
Revenue		339,650
Cost of sales	207,750	
Distribution cost	27,500	
Administrative expenses	30,700	
Finance cost	2,400	
	500,950	500,950

Additional information:

1. Inventory as at 31 March 2014 include goods valued at Sh.1,500,000 which were declared obsolete.
2. Depreciation is to be charged as follows:

Asset	Rate per annum	Method
• Building	5%	Straight line
• Plant and equipment	20%	Reducing balance

3. The bank loan is being repaid in ten equal instalments. Half of the loan has already been paid.
4. Allowance for doubtful debts of 5% of the trade receivables is to be made.
5. The balance on current tax represents an over provision of the tax liability for the year ended 31 March 2013. The required provision for income tax for the year ended 31 March 2014 is Sh.18.4 million.
6. Finance cost in the trial balance comprises of:

	Sh. "000"
Interest on bank loan	1,200
Interest on debenture	1,200
	2,400

7. The directors have proposed a dividend of 10%.

Required:

(a) Statement of comprehensive income for the year ended 31 March 2014. (10 marks)

(b) Statement of financial position as at 31 March 2014. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Financial "shenanigans" are actions or omissions (tricks) intended to hide or distort the real financial performance or condition of a business entity. They range from minor deceptions to more serious misapplications of accounting principles.

Required:

Citing relevant examples, explain three "shenanigans" that securities and investment analysts should look for when analysing financial statements. (6 marks)

(b) The following are the financial statements of Adpak Ltd. for the year ended 31 December 2013:

Income statement for the year ended 31 December 2013:

Sh. "000"

Revenue	12,000
Cost of sales	(7,000)
Gross profit	5,000
Operating expenses	(2,000)
Operating profit	3,000
Finance cost	(2,200)
Earning before tax	800
Income tax expense	(240)
Profit for the year	560

Statement of financial position as at 31 December 2013:

	Sh. "000"	Sh. "000"
Non-current assets:		
Tangible assets		21,000
Intangible assets		7,000
		28,000
Current assets:		
Inventory	8,000	
Trade receivables	6,000	
Bank balance	800	14,800
Total assets		42,800
Financed by:		
Equity and liabilities:		
Equity:		
100,000 preference shares Sh.20 each		2,000
500,000 ordinary shares Sh.4 each		2,000
Share premium		4,000
Retained earnings		2,800
		10,800
Non-current liabilities:		
Mortgage (20 years)	8,000	
8% Debentures	12,000	20,000
Total equity and reserves		30,800
Current liabilities:		
Trade payables	2,000	
Notes payable	10,000	12,000
Total liabilities and equity		42,800

Additional information:

1. The Z score is to be calculated using the following formular:
   $Z\text{-Score} = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 0.999X_5$

   Where: X_1 = Working capital/total assets
   X_2 = Retained earnings/total assets
   X_3 = Earnings before interest and tax/total assets
   X_4 = Market value of equity/Book value of debt
   X_5 = Sales/total assets
2. The current market price per share is Sh.6.

Required:

(i) Calculate the Z-Score of the company and interpret its meaning. (8 marks)

(ii) Evaluate the applicability of the Altman Z-Score in your country. (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Highlight three methods for recognition of actuarial gains or losses with reference to IAS 19 (Employee Benefits). (6 marks)

(b) The following are the financial statements of Bela Ltd. and its subsidiary, Dola Ltd.:

Income statement for the year ended 31 October 2013

	Bela Limited Sh. "million"	Dola Limited Sh. "million"
Sales	1,000	250
Cost of sales	(650)	(180)
Gross profit	350	70
Distribution costs	(75)	(15)
Administrative expenses	(60)	(20)
Operating profit	215	35
Investment income	14	0
Profit before tax	229	35
Less income tax	(70)	(10)
Profit after tax	159	25
Less proposed dividend	(80)	(15)
Retained profit for the year	79	10

Statement of financial position as at 31 October 2013.

	Bela Limited Sh. "million"	Bela Limited Sh. "million"	Dola Limited Sh. "million"	Dola Limited Sh. "million"
Non-current assets:				
Tangible assets (net book value)		350		75
Investment shares in Dola Ltd. (cost)		100		
		450		75
Current assets:				
Inventory	180		45	
Trade receivables	145		55	
Bank	70	395	20	120
Total assets		845		195
Financed by:				
Equity and liabilities				
Finance:				
Ordinary share capital		500		100
Retained earnings		145		40
Non-current liabilities:		645		140
Income tax				
		70		10
		70		10
Current liabilities:				
Trade payables	50		30	
Proposed dividends	80	130	15	45
Total equity and liabilities		845		195

Additional information:

1. Bela Ltd. acquired 80% of the issued ordinary share capital of Dola Ltd. on 1 November 2011 when the retained earnings of Dola Ltd. were Sh.20 million. Goodwill is amortised over its estimated useful life of four years.
2. Bela Ltd. sold goods costing Sh.100 million to Dola Ltd. for Sh.160 million during the year ended 31 October 2013. As at 31 October 2013, 25% of these goods remained in Dola Ltd.
3. Bela Ltd. has recognised the dividend proposed by Dola Ltd. in its income statement.

Required:

Consolidated statement of financial position as at 31 October 2013. (14 marks)

(Total: 20 marks)

CSIA PART II SECTION 3

FINANCIAL STATEMENT ANALYSIS

FRIDAY: 7 June 2013 **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

The following financial statements were extracted from the books of Ngano ltd. For the year ended 31 December 2011 and 31 December 2012:

Income statement for the year ended 31 December:

	2011	**2012**
	Sh."000"	**Sh."000"**
Revenue	20,000	26,000
Cost of sales	(15,400)	(21,050)
Gross profit	4,600	4,950
Administrative expenses	(800)	(900)
Selling and distribution expenses	(1,550)	(1,565)
Depreciation	(110)	(200)
Debenture interest	-	(105)
Profit for the year	2,140	2,180

Statement of financial position as at 31 December

	2011	**2012**
	Sh."000"	**Sh."000"**
Non-current assets at cost	4,600	5,600
Accumulated depreciation	(800)	(1,000)
Net book value	3,800	4,600
Current assets:		
Inventory	6,000	6,700
Trade receivables	4,400	6,740
Bank balances	120	960
	10,520	14,400
	14,320	**19,000**
Equity and liabilities:		
Ordinary share capital	8,000	8,000
Retained profits	3,120	5,300
	11,120	13,300
Non-current liabilities:		
7% Debentures	-	1,500
Current liabilities	3,200	4,200
	14,320	**19,000**

Required:

(a) i. Gross profit margin (2 marks)

ii. Net profit margin (2 marks)
iii. Return on equity (2 marks)
iv. Stock turn over (2 marks)
v. Quick ratio (2 marks)
vi. Debtors collection period (2 marks)

(b) Based on the ratios calculated in (a) above, comment on the performance of the company

(8 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain the following forms of joint venture in the context of International Accounting Standards (IAS) 31 "interest in joint venture"

i. Jointly controlled operations (2 marks)
ii. Jointly controlled assets (2 marks)
iii. Jointly controlled entities (2 marks)

(b) On January 2012, kika ltd. Acquired 30% of kaka ltd ordinary shares for sh.500, 000 cash. It is determined that kika ltd. has the ability to exert significant influence on kaka ltd's financial and opening decisions.

The following information concerning kaka ltd's assets and liabilities on 1st January 2012 is provided

Kaka ltd

	Book value Sh.	**Fair value Sh.**	**differences Sh.**
Current assets	100,000	100,000	-
Plant and equipment	1,900,000	2,200,000	300,000
	2,000,000	2,300,000	300,000
Less liabilities	(800,000)	(800,000)	-
Net assets	1,200,000	1,500,000	300,000

Plant and equipment are depreciated on a straight line basis and have 10 years of remaining useful life. Kaka ltd's reported a net income of sh.100, 000 and paid dividends of sh.50, 000 for the year ended 31 December 2012.

Required:

i. Goodwill included in the purchase price (4 marks)
ii. Investment in the associate entity, at the end of year 2012 (4 marks)

(c) Peris Omwamo, a Certified Securities and Investment Analyst (CSIA), has been consulted to analyze PKG ltd. Which is planning to raise new debt? Part of her analysis involves understanding PKG ltd's solvency so as to determine its capacity to handle additional debt. During the analysis, peris Omwamo observed that in the year 2012, PKG ltd. Undertook an asset reveluation that increased the depreciation expense by sh.2.5 million. The following excerpts were Provided to her from the financial statements of PKG limited.

Statement of financial position as at 31 December:

	2011 Sh."million"	2012 Sh."million"
Plant, property and equipment (net book value)	700	750
Total assets	3,000	3,650
Total liabilities	1,400	1,900
Revaluation surplus (part of shareholders' equity)	-	150
Total shareholders' equity	1,600	1,750

Statement of comprehensive income for the year ended 31 December:

	2011 Sh."million"	2012 Sh."million"
Depreciation expense	100	125
Income before taxes	1,000	975
Tax expense	400	400
Net income	600	575

Additional information:

1. Asset revaluation is not taxable
2. Any increase in depreciation expense related to the revaluation is not deductable

Required:

Based on IFRS 5 "non-current assets held for sale and discontinued operations", compute PKG ltd's financial leverage using the 2012 financial statements:

i. With no adjustment for the asset revaluation (2 marks)
ii. With adjustment for asset revaluation (3 marks)

Interprete the change in leverage computed in (c) (i) and (ii) above (1 marks)

(Total: 20 marks)

QUESTION THREE

(a) (i) Argue the case for including a portion of deferred taxes as equity and a portion as debt.(2 marks)

(ii) Explain three factors that influence the level and trend of reported deferred taxes among firms.

(6 marks)

(b) Dunga ltd And Kanda ltd Use International Accounting Standards (IAS) 19 "employees' benefits" to account for their pension plans. The following information relates to the companies' pension plans for the year ended 30 April 2013.

1. On 1st May 2012, the pension plan assets of both companies were fairly valued at ksh.200 million. Both companies had net unrecognized actuarial gains of sh.6 millions
2. On 30th April 2013, the fair value of the pension plan assets of Dunga ltd, was sh.219 millions and that of Kanda ltd was sh.276 millions
3. The contributions received were sh.70 millions and benefits paid were sh.26 millions for both companies. These amounts were paid and received on 1st November 2012

4. The expected return for both companies, pension plan assets was 7% on 1st May 2012
5. The present value of the defined benefit obligation was less than the fair value of the company's pension plan assets on 1st May 2012 and 30th April 2013
6. Actuarial losses on the obligation for the year were negligible for both companies

Required:

Using the corridor approach, calculate the actuarial gain or loss for Dunga ltd and Kanda ltd arising in the year ended 31 April 2013. Comment on the results (12 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Financial statement analysis is a very imperative device but the financial is a very imperative device but the financial analysts must keep in mind its limitations. Discuss six limitations associated with the analysis of financial statements. (6 marks)

(b) Describe two incentives that could lead to manipulation of financial statements by the management of a firm. (4 marks)

(c) Pakacha ltd issued one new share for every two existing shares held by way of rights at sh. 1.50 per share on 1st July 2012. The market price per share as at July 2012 was sh.3.00

The following information is available:

	2012	**2011**
Profit attributable to ordinary shareholders (sh) for the year ended	550,000	460,000
Number of ordinary shares in issue as at 31 December	1,200,000	800,000

Required:

i. Earnings per share (EPS) for the year ended 2012 (7 marks)
ii. Retained earnings per share (EPS) for the year ended 2011 (3 marks)

(Total: 20 marks)

QUESTION FIVE

The following financial statements were extracted from the books of Kimbo ltd.

Statement of comprehensive income for the year ended 30th June 2012

	Sh"000"
Revenue	11,480
Cost of sales	9,680
Gross profit	1,800
Income from and gains on investing	120
Distribution costs	(240)
Administrative expenses	(700)
Finance cost	(100)
Profit before tax	880
Income tax expense	(320)
Profit for the year	560
Other comprehensive income:	
Gains on property revaluation	200
Total comprehensive income	760

Statement of financial position as at 31 December

	2012 Sh."000"	2011 Sh."000"
Non-current assets at cost(see note 1):		
Property, plant and equipment	5,760	3,720
Investment property	840	800
	6,600	4,520
Current assets:		
Inventory	2,420	1,620
Trade receivables	960	1,080
Income tax assets	-	100
Bank balances	20	-
	3,400	2,800
Total assets	**10,000**	**7,320**
Equity and liabilities:		
Equity shares of 0.20 each(see note 3)	2,000	1,200
Share premium	1,200	-
Revaluation reserve	300	100
Retained profits	2,880	2,620
	6,380	3,920
Non-current liabilities:		
6% loan note (see note 2)	-	800
Deferred tax	100	60
	100	860
Current liabilities:		
Trade payable	2,820	2,100
Bank over draft	-	240
Warranty provision (see note 4)	400	200
Current tax payable	300	-
	3,520	2,540
Total equity and liabilities	**10,000**	**7,320**

Additional information:

1. An item of plant with a carrying amount of sh, 480,000 was sold at a loss of sh.180, 000 during the year ended 30th June 2012. Depreciation of sh. 560,000 on property , plant and equipment was charged to cost of sales in the year ended 30th June 2012
2. The 6%loan notes were redeemed before maturity incurring a penalty for early payment of sh.40,000 which has been charged as an administrative expense in the income statement
3. There was an issue of shares for cash during the year ended 30th June 2012
4. Kimbo ltd gives a 12 month warranty on some of the products it sells. The amounts shown in the current liabilities as warranty provision are an accurate assessment based on past experience of the amount of claims likely to be made in respect of warranties outstanding at each year end. Warranty costs are included in cost of sales.
5. A dividend of sh.0.03 per share was paid during the year ended 30th June 2012.

   Required:

   Statement of cash flow for Kimbo ltd for the year ended 30th June 2012 in accordance with IAS 7 (statement of cash flows)

(Total: 20 marks)

CSIA PART II SECTION 3

FINANCIAL STATEMENT ANALYSIS

THURSDAY: 6 December 2012 **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

The following financial statements were extracted from the books of Venix Limited for the year ended 31st October 2011 and 2012

Venix Limited
Income statement for the year ended 31 October:

	2012 Sh."000"	2011 Sh."000"
Revenue	25,500	17,250
Cost of sales	(14,800)	(10,350)
Gross profit	10,700	6,900
Distribution cost	(2,700)	(1,800)
Administrative expenses	(2,100)	(1,500)
Finance cost	(650)	(100)
Profit before tax	5,250	3,500
Income tax expense	(2,250)	(1,000)
Profit for the year	**3,000**	**2,500**

Venix Limited
Statement of financial position as at 31 October

		2011 Sh."000"		2012 Sh."000"
Non-current assets at cost:				
Plant, property and equipment		9,500		5,400
Intangible assets		6,200		-
		15,700		5,400
Current assets:				
Inventory	3,600		1,800	
Accounts receivable	2,400		1,400	
Bank	-		4,000	
Non-current assets held for sale	2,000	8,000	-	7,200
		23,700		**12,600**
Equity and liabilities:				
Ordinary share capital(sh.10 par value)	5,000			5,000
Retained profits	4,500			2,250
	9,500			7,250
Non-current liabilities:				
5%loan stock		2,000		2,000
8% loan stock		7,000		-
Current liabilities:				
Bank overdraft	200		-	
Accounts payable	2,800		2,150	
Current tax	2,200	5,200	1,200	3,350
		23,700		**12,600**

Additional information:

1. There were no disposals of non-current assets during the period; however, Venix limited does have some non-current assets classified as 'held for sale' at 31st October 2012
2. Depreciation on property, plant and equipment for the year ended 31st October 2012 was sh.640,000
3. A disappointed shareholder has observed that although revenue during the year has increased by 48%, profit for the year has only increased by 20%
   Required:

(a) Statement of cash flow (in conformity with IAS 7, statement of cash flows) for the year ended 31 October 2012. (10 marks)

(b) Using suitable ratios, comment on the performance and financial position of Venix limited for the year ended 31 October 2012. (10 marks)

(Total: 20 marks)

QUESTION TWO

(a) Outline two types of information which could be obtained from the following sources:

i. Proxy statement (2 marks)
ii. Corporate press release (2 marks)
iii. Annual reports to regulators (2 marks)

(b) The top management of Zedrock Limited has provided you with the following financial statements relating to its two divisions, alpha and beta, for the year ended 30 June 2012

Income statement for the year ended 30 June 2012

	Alpha Division Sh."millions"		**Beta Division Sh."millions"**	
Revenue		4,000		6,000
Cost of sales		(3,000)		(4,800)
Gross profit		1,000		1,200
Expenses:				
Distribution costs	200		150	
Administrative expenses	290		250	
Interest paid	10	(500)	400	(800)
Profit before tax		500		400
Income tax expense		(120)		(90)
Profit after tax		380		310
Dividend paid		(150)		(100)
Retained profit for the year		230		210
Retained profit brought forward		220		2,480
Retained profit carried forward		**450**		**2,6900**

Statement of financial position as at 30 June 2012:

	Alpha Division Sh."millions"		Beta Division Sh."millions"	
Non-current assets at cost:				
Land and buildings		1,200		5,000
Furniture and motor vehicles		600		1,000
		1,800		6,000
Current assets:				
Inventory	400		800	
Trade receivables	850		750	
Financial assets	100		230	
Cash at bank	-	1,350	100	1,880
Total assets		**3,150**		**7,880**
Equity and liabilities:				
Ordinary share capital(sh.1 par value)		1,000		1,600
Retained profits		450		2,690
		1,450		4,290
Non-current liabilities:				
Bank loan		500		3,000
Current liabilities:				
Accounts payable	1,080		590	
Bank overdraft	120	1,200	-	590
		3,150		**7,880**

Additional information:

1. The two divisions sell goods on both cash and credit terms. On average, the credit sales account for 80% of the total sales while purchases account for 90%
2. The cash flow from operating activities for the two divisions are sh.750 millions and sh.800 million respectively.
3. The division deal with electronic goods.

Required:

(i) Common size income statement for the year ended 30th June 2012 (6 marks)

(ii) Common size statement of financial position as at 30th June 2012 (6 marks)

(iii)Comment on the performance of the two divisions and state which division and state is better (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) In context of IAS 18 "revenue"

i. Define the term revenue (2 marks)
ii. Outline four criteria to be followed in recognizing revenue from the sale of goods (4 marks)

(b) Summarize four factors that might affect the quality of earnings of a firm (4 marks)

(a) At 1 October 2011, Celltech limited had in issue 36 Million ordinary shares, 10 million 6% redeemable preference shares (sh.10 par value) and sh.10million 8% convertible loan stock

The loan stock will mature in 2012 and will be redeemable at par or be converted to ordinary share on the basis of 25 shares for each sh.100 of the loan stock at the holder option

On 1 January 2012, Celltech Limited made a fully subscribed rights issue of one new share for every four shares held at a price of sh.28 each.

The market price of the ordinary shares immediately before the issue was sh.38. The profit after tax for the year ended 30 September 2012 was sh.15 million, the earning per share (EPS) was sh. 0.30 for the year ended 30 September 2011.

The income tax rate is 30%.

Required:

(i) Basic earnings per share (EPS) as at 30 September 2012 (5 marks)

(ii) Diluted EPS (comparative not required)as at September 2012 (5 marks)

(Total: 20 marks)

QUESTION FOUR

(a) (i) Explain the rationale behind providing deferred tax based on temporary differences (4 marks)

(ii) Polytech Limited has a deferred tax liability of sh.100 million as at 1 October 2011. During the year ended 30 September 2012, the following information was available for computation of deferred tax:

1. Property, plant and equipment had a carrying amount of sh. 1,200 million and a tax base of sh.1,000 million. Some land and building were revalued upwards by sh.50 million during the year ended 30 September 2012
2. Intangible assets consisting of trade licenses being amortized over five years had a carrying amount of sh.60million. this has been allowed for tax purposes
3. The company has available for sale financial assets with a carrying amount of sh.20 millions and financial assets at fair value through profit and loss of shillings 10 million. Both financial assets reported losses in fair value of sh.2 million each as at 30th September 2012
4. Inventory is shown at the lower of cost and net realizable value. The cost is sh.800 million while net realizable value is sh.780 million
5. Trade receivables had a carrying amount of sh.500 million (unrealized). Both the allowance and exchange gain are not allowed for tax purposes
6. Trade and other payables are stated at sh.900 million after making a provision for discount of sh.10 million

   Assume a tax rate of 30%.

   Required:

   Temporary differences for the year ended 30 September 2012. (6 marks)

(b) Tedcomp Limited prepares its financial statements on 30 September each year. The company makes contribution to a defined plan for its employees. The company accounts for actuarial gains and losses arising on these arrangements using the 10% corridor method.

Additional information:

1. At 1 October 2011, the plain obligation was sh.42 million and the fair value of the plan assets was sh.36 million
   Unrecognized actuarial losses at that date totaled sh.7.8 million.
2. The actuary advised that the current service cost for the year ended 30 September 2012 was sh.4.8 million. Tedcomp Limited paid contribution of sh.3.84 million to the plan on 30 September 2012. These were the only contribution paid in the year.
3. The expected annual rate of return on plan assets at 1 October 2011 was 5%. They actuary revised this estimate to 4% at 30 September 2012
4. The appropriate annual rate at which to discount the plan liabilities was 6% on 1 October 2011 and 5.5% on 30 September 2012
5. The plan paid our benefits totaling sh.2.4 million to retired members on 30 September 2012
6. At 30September 2012 the plan obligation was sh.49.8 millions and the fair value of the plan asset was sh.39 million
7. The average remaining service life of plan members still in employment was estimated to be 20 years.
   Tedcom Limited policy is to recognize the excess of the limits over the average service life of employees.
   Required:

(i) Income statement (extract) for the year ended 30 September 2012 (5 marks)

(ii) Statement of financial position (extract) as at 30 September 2012 (5 marks)

(Total: 20 marks)

QUESTION FIVE
(a) Describe two limitations of operating segment analysis in comparing different entities. (2 marks)

(b) Summarize four defects of historical cost accounting during inflation periods. (4 marks)

(c) Kubwa Limited acquired 25% of the equity share of Ndogo Limited several years ago when the retained earnings of Ndogo Limited were sh.120 million. Ndogo limited operates as a separate entity under contractual agreement between kubwa limited and three other parties, each party holding an equal proportion of the equity share capital. The investment in Ndogo limited is held at cost in Kubwa Limited's individual financial statement and has been correctly classified as a joint venture.

Statement of financial position as at 31 October 2012

	Kubwa limited	**Ndogo limited**
Non-current assets:	**Sh."million"**	**Sh."million"**
Plant, property and equipment	966	840
Investment in Ndogo	210	-
	1,176	840
Current assets:		
Inventory	333	360
Trade receivable	345	396
Held for trading investment	105	-
Cash and cash equivalents	63	120
	846	876
Total assets	**2,022**	**1,716**

Equity and liabilities:		
share capital(sh.1 par value)	360	600
Revaluation reserve	54	-
Retained profits	639	360
Total equity	1,053	960
Non-current liabilities:		
Long term borrowing	270	-
Current liabilities:		
Trades payables	555	480
Income tax payable	144	276
	699	756
Total liabilities	969	756
Total equity and liabilities	**2,022**	**1,716**

Additional information:

1. During the year, Ndogo Limited sold goods to Kubwa limited for ksh.600 million. Half of these goods remain in Kubwa limited inventory at 31 October 2012. Ndogo limited makes a 20% margin on all sales. The most recent sales invoice for sh.72 millions sent from Ndogo limited to Kubwa limited in respect of these sales remains outstanding at the year end.

2. Kubwa Limited holds another investment, which it has correctly classified as held for trading. The fair value of this investment at 31 October 2012 was sh.126 million, although this has not yet been reflected in the financial statements.

Required:

Consolidated statement of financial position as at 3October 2012. (4 marks)

(Total marks: 20 marks)

CSIA PART II SECTION 3

FINANCIAL STATEMENT ANALYSIS

THURSDAY: 31 MAY 2012 **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

The following balances were extracted from the books of Mali commercial Bank ltd on 31 December 2011.

	Sh."000"
Government securities	2,344,000
Loans and advances	5,946,000
Cash and balances with central bank	1,257,000
Other money market placements	34,600
Property, plant and equipment	1,008,000
Interest on loans and advances	870,800
Interest on government securities	476,400
Foreign exchange income	144,000
Fees and commissions income	340,400
Deposits with other banks	230,000
Other fixed assets	64,000
Interest on placement and bank balances	72,000
Non-operating income	34,000
Customers deposits	8,480,000
Deposits and balances due to other banks	430,000
Depreciation expense	84,000
Directors emoluments	25,000
Bad and doubtful debts expense	68,000
Interim dividends paid	50,000
Staff costs	590,000
Interest on customers deposit	230,000
Interest on borrowed fund	70,000
Ordinary share capital	500,000
Auditors remuneration	7,000
Contribution to staff provident fund	29,000
Loss on sale of fixed assets	43,600
General administration expense	285,000
Reserves	1,058,000
Legal and professional fees	40,000

Additional information:

1. Current tax has been estimated at sh.240, 000,000.
2. Final dividends have been proposed at 20%.
3. Accrued interest expense on customers' deposits as at 31 December 2011 was sh.60, 000,000

Unrecorded interest income on loans and advances to customers was sh.300, 000,000 as at 31 December 2011.

Required:

Prepare the following statements in accordance with International Financial Reporting Standards (IFRS):

(a) A statement of comprehensive income for the year ended 31 December 2011. (12 marks)

(b) A statement of financial position as at 31 December 2011. (8 marks)

(Total: 20 marks)

QUESTION TWO

(a) Identify the key issues that may be contained in each of the following reports:

(i) Director's report (2 marks)

(ii) Auditor's report (2 marks)

(iii) Chairman's report (2 marks)

(b) Matokeo logistics limited is a major service provider in the logistics and cargo transport from the port of Mombasa to various destinations in the world. In the recent years, there have been reported complaints about the services provided by the company. In the last one year, the company has invested over sh.400 million in new equipment and trucks in an attempt to address these criticisms. The summarized financial results for Matokeo logistics limited for the years ended 30 April 2011 and 30 April 2012 are given below:

Matokeo logistics Limited

Summarized income statement for the year ended 30 April:

	2011	**2012**
	Sh."million"	**Sh."million"**
Sales Revenue	3,600	3,700
Earnings before interest and tax (EBIT)	360	330
Interest expense	(64)	(94
Taxation	(88)	(70)
Earnings available to ordinary shareholders	**208**	**166**

Matokeo logistics Limited

Summarized Statement of financial position as at 30 April

		2011		**2012**
		Sh."million"		**Sh."million"**
Non-current assets at cost		2,008		2,410
Current assets:				
Inventory	106		118	
Trade receivables	42		48	
Cash and Bank balances	124	272	72	238
		2,280		**2,648**
Equity and liabilities:				
Ordinary share capital(sh.1 each)		500		500
Retained profits		912		964
		1,412		1,464
Non-current liabilities:				
8% Debenture	300			300
Bank loan	400			700
Current liabilities:				
Trade payables	168	868		184
		2,280		**2,648**

Required:

Calculate the following rations for Matokeo logistics limited for the year ended 30 April 2011 and 30 April 2012:

i.	Return on capital employed (ROCE)	(2 marks)
ii.	Net profit margin	(2 marks)
iii.	Assets turnover	(2 marks)
iv.	Current ratio	(2 marks)

(c) Briefly comment on the financial performance of Matokeo Logistics Limited in 2011 and 2012 as revealed by the above ratios. Suggest causes for any changes. (2 marks)

(d) Suggest two non-financial indicators that could be useful in measuring the performance of Matokeo Logistics limited. State why your chosen indicators are important (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Alpha Ltd is a subsidiary of beta ltd. Information based on the income statements of each company for the year ended 31 March 2012 is provided below:

Income statement for the year ended 30 June 2012

	Alpha Division Sh."000"	Beta Division Sh."000"
Revenue	17,540	2,474
Cost of sales	(10,625)	(1,562)
Gross profit	6,915	912
Administrative expenses	(1,763)	(239)
Selling and distribution expenses	(604)	(87)
Finance cost	(175)	(31)
Profit before tax	4,373	555
Income tax expense	(853)	(118)
Profit for the year	**3,520**	**437**

Additional information:

1. During the year alpha ltd sold goods to beta ltd forsh.32, 000. The goods had cost alpha sh.25, 000. At 31 March 2012, only 80% of the goods had been sold by beta ltd.

2. Alpha ltd had acquired 80,000 of the 100,000 sh.10 shares of Beta ltd on November 2010 for sh.21 million. At that date, the fair value of 1 share in beta ltd was estimated to be sh.25 and book value of Beta ltd. Equity was sh.18, 750,400

3. It was estimated that on acquisition, the fair value for all the assets of Beta ltd were the same as their book values, with the exception of land. The land was estimated to have a fair value of sh.120, 600 greater than the book value.

4. The directors use the partial method to determine goodwill arising on acquisition and have calculated that on 31 March 2012, the value of the group's share of goodwill had fallen to sh.1, 850,000

Required:

(i) Determine the group share of goodwill arising on the acquisition of bête ltd. (2 marks)

(ii) Consolidated income statement for the year ended 31 March 2012 (8 marks)

(b) The consolidated income statement of Pasar ltd. For the year ended 31 May 2011 and 31 May 2012 include the information shown below.

	2012 Sh."million"	**2011 Sh."million"**
Revenue	615.7	592.8
Operating profit	88.4	71.8
Net interest receivable/payable	0.2	(1.3)
Profit before tax	88.6	70.5
Tax on ordinary activities	(25.7)	(19.4)
Profit after tax	62.9	51.1
Non-controlling interest	(8.1)	(7.4)
Profit for the year	54.8	43.7
Dividends paid	(18.3)	(15.8)
Retained profit for the year	36.5	27.9

Additional information:

1. As at May 2012 the company's issued share capital were 20,800,000 ordinary shares of sh.10 each. Additional shares were issued as follows in the year 2010 and 2011:

    1 December 2010 – a cash issue which raised sh.46, 670,000
    1 October 2011 – a rights issue of 1 for every 3 shares at sh.10.50

2. The market price of the company's shares was reported as follows:

	Sh.
1 June 2010	17.50
1 December 2010	17.95
1 October 2011	14.10
31 May 2012	15.80

Required:

The basic earnings per share (EPS) for the year ended 31 May 2011 and May 2012 (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Briefly explain three economic factors that affect interest rates. (6 marks)

(b) Hekay limited issued a five year, 10% convertible loan at sh.10 million on 1 January 2012. The loan stock could be converted into 500,000 sh.10 ordinary shares at any time before maturity. Interest rate for similar loan stocks without a conversion option is 12%.

Required:

(i) Explain how the loan stock could be classified according to International Accounting Standards (IAS) 32 (Financial instruments presentation). (2 marks)

(ii) If the loan stock is not converted into ordinary shares, explain how it will be accounted for and presented in the financial statements over the next five years up to 2016.

Assume that interest is paid annually. (8 marks)

(iii) Assume that the loan stock is converted into ordinary shares on 15 January 2014. Give the journal entries to record the conversion. (4 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain three problems associated with accounting treatment of post employment benefits (6 marks)

(b) Babika Limited operates defined scheme for the members of staff. The following data relates to the scheme over the past three years ended 31 May 2010, 31 May2011 and 31 May 2012:

	2010	**2011**	**2012**
	Sh."million"	**Sh."million"**	**Sh."million"**
Current service cost	130	140	150
Benefits paid	150	180	190
Contribution paid	90	100	110
Present value of obligations – 31May	1,100	1,380	1,408
Fair value of scheme assets at 31 May	1,190	1,372	1,188
Discount rate at start of the year	10%	9%	8%
Expected rate of return on the scheme assets	12%	11%	10%

Additional information:

1. The present value of obligations and fair value of scheme assets as at 1 June 2009 was sh.1,000 million.
2. The company recognizes all actuarial gains and losses arising during the period in the retained profits.

Required:

(i) Income statement for the year ended 31 May 2010, 31 May 2011 and 31 May 2012 (6 marks)

(ii) Statement of financial position as at 31 May 2010, 31 may 2011 and 31 May 2012 (6 marks)

(c) Patmos ltdis considering adding a new division in the manufacturing department. The addition will result in a 20% increase in the existing profit margin and a 40% increase in total assets. The increase will be financed with debt.

The following ratios existed before the change in assets.

1. $profit\ margin\ (M) = \frac{net\ \ income}{sales} = 0.12$

2. $Total\ asset\ turnover\ (T) = \frac{sales}{Total\ \ assets} = 2.5$

3. $Equity\ Multiplier\ (EM) = \frac{Total\ \ assets}{Equity} = 1.5$

Required:

The new return on equity (ROE) if sales remain Constant (5 marks)

(Total: 20 marks)

CSIA PART II SECTION 3

FINANCIAL STATEMENT ANALYSIS

THURSDAY: 1 December 2011 **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

The following trial balance relate to Ziwani Limited as at October 2011:

	Sh."000"	**Sh."000"**
Ordinary share capital(sh.10 each)		56,000
Retained earnings (1 November 2010)		1,400
8% convertible loan stock		30,000
Freehold property at cost 1 November 2010:		
(land element sh.25 million)	75,000	
Plant and equipment (at cost)	74,500	
Accumulated depreciation (1 November 2010):		
Building		10,000
Plant and equipment		24,500
Current tax		800
Deferred tax		2,600
Inventory: 4 November 2011	36,000	
Trade receivables	47,100	
Bank loan		11,500
Trade payables		24,500
Revenues		339,650
Cost of sales	207,750	
Distribution costs	27,500	
Administrative expenses	30,700	
Interest paid on convertible loan stock	2,400	
	500,950	**500,950**

Additional information:

1. The inventory of Ziwani limited was not counted until 4 November 2011 due to operation reasons. At this date, the cost of this inventory was sh.36million and this figure had been used in the cost of sales calculation above. Between the year ended 31 October 2011 and 4 November, Ziwani limited received a delivery of goods at a cost of sh.2.7 million and made sales of sh.7.8 million at a markup on cost of 30%. Neither the goods delivered nor the sales made in this period were included in Ziwani limited's purchases (as part of cost of sales) or revenues in the above trial balance.
2. On 1 November 2010, Ziwani limited decided, for the first time, to value its freehold property. A qualified property valuer reported that the market value of the freehold property on this date was sh.80million of which sh.30million related to the land. At this date, the remaining estimated life of the building was 20 years. Plant is depreciated at 20% per annum on a reducing balance method.
3. The bank loan is being repaid in ten equal installments which commenced on 1 November 2006.
4. Provision for doubtful debts of 5% of the trade receivables is to be made.
5. The balance on current tax represents the under/over provisions of the tax liability for the year ended 31 October 2011. The required provision for income tax for the year ended 31 October 2011 is sh. 19.4 million. The net temporary differences during the year were determined as sh.19.8 million.
6. Income tax and deferred tax are provided at a rate of 30% on all items giving rise to tal
7. Provision is to be made for the following items:

   Interest on bank loan sh.1.84 million

Proposed dividends of 10%

Required:

(a) Statement of comprehensive income for the year ended 31 October 2011 (8 marks)

(b) Statement of changes in equity for the year ended 31 October 2011 (4 marks)

(c) Statement of financial position 31 October 2011 (8 marks)

(Total: 20 marks)

QUESTION TWO

(a) Describe the following sources of financial information:

(i) Footnotes (2 marks)

(ii) Management Discussion and analysis (2 marks)

(b) The following is an extract from Rafiki limited's statement of comprehensive income and statement of financial position December 2010:

Debt	sh.12 million
Equity	sh.20 million
Interest expense	Sh. 1 million
Time interest earned	5.0x

Additional information:

1. At the beginning of 2010, Rafiki limited entered into an operation lease with future payment of sh.40 million with discounted present value of sh.20 million
2. Rafiki limited has guaranteed a sh.5million, 10% bond issue, due in 2016 issued by Kwanza ltd a non consolidated 30% owned affiliate
3. Rafiki limited committed itself (starting in 2011) to purchase a total of sh.12 million of copper rolls from Coproll ltd, its major supplier over the next five years. The estimated present value of these payments is sh.7million

Required:

(i) Discuss the reasons (both financial and operating) why Rafiki limited might have entered into these arrangements (4 marks)

(ii) Describe the additional information required, to fully evaluate the impact of these commitments on Rafiki limited's current financial position and future operating trend. (4 marks)

(c) Tana limited has provided the information below regarding its operations and subsidiaries for the year ended 31 December 2010:

	Sh."000"
Sales to customers outside the group by Uganda companies	27,000
Assets used by Tanzania companies	32,400
Assets used by Uganda companies	43,200
Assets used by bureaus services	18,765
Sales not allocated to Uganda, Tanzania or other areas	2,700
Sales made by the group to other areas	1,350
Expenses not allocated to Uganda, Tanzania or other areas	4,590
Sales to customers outside the group by Tanzania companies	6,750
Sales by Tanzania companies to group members	2,160
Sales by Uganda companies to group members	2,700
Assets used by the group in other areas	18,360
Assets not allocated to Uganda, Tanzania or other areas	12,555

segment net operating profit by geographical areas:

	Sh. "000"
Uganda	5,130
Tanzania	2,430
Other areas	270

Consolidated segmental net operating profit by geographical area sh.7, 155,000

Required:

Geographical segmental report for inclusion in the annual report (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) Mambo limited operates retail outlets in the east African region. The company intends to raise sh.375 million to expand its operations to Southern Sudan. It can raise the finances using any of the following:

Option 1 - Issue 10% preference shares redeemable in 10 years
Option 2 – A rights issue at sh.4 per share
Option 3 – Issue 10% debentures redeemable in 10 years

The current financial statements of Mambo ltd for the year ended 30 November 2011 are as follows:

Consolidated income statement for the year ended 30 November 2011:

	Sh."million"
Revenue	3,750
Cost of sales	(2,250)
Gross profit	1,500
Administration cost	1,050
Profit before interest and tax	450
Less interest expense	(22.5)
Profit before tax	427.5)
Less income tax expense	(128.25
Profit after tax	299.25
Less dividends	(179.55)
Retained profit	**119.7**

Statement of financial position as at 30 November 2011

	Sh." million"
Non-current assets at cost	1,507.5
Net current assets	372
	1,879.5
Ordinary share capital(sh.0.25 par value)	187.5
Retained profits	1,504.5
12% Debentures	187.5
	1,879.5

Additional information:

1. The expansion in the retail outlet is expected to increase sales by 15% in the year ending 30 November 2012.
2. Variable cost is 75% of cost of sales
3. Administration costs will increase by 8% due to additional staff remitted
4. The company will maintain the policy of paying out 60% of profit after tax as dividend and no overdraft will be obtained
5. Corporation tax rate is 30%

Required:

(i) For each of the financing options, prepare the forecast income statement for the year ending 30 November 2012 clearly showing the earnings per share (EPS) for each option. (9 marks)

(ii) Based on the EPS calculated in (a) (i) above, advice the management on the best option to finance its operations. (1 mark)

(iii) Calculate the break-even point (BEP) in shillings under each of the financing options (6 marks)

(b) Outline four categories of financial instruments which should be disclosed in the statement of financial position as per IFRS 7 (Financial Instruments Disclosure) (4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Biscuit ltd commenced operations in January 2000 dealing in computers, printers, fax machines and photocopiers among others

Assume that you are working for a financial institution and the management of biscuit have approached your institution for an overdraft facility of sh.400, 000,000.

The following financial statements have been prepared for the two years ended 30 June 2010 and 30 June 2011.

Income statement for the year ended 30 June:

	2011 Sh."000"	2010 Sh."000"
Revenue	4,306,533	2,027,310
Cost of sales	(3,289,702)	(1,503,999)
Gross profit	1,016,831	523,311
Administrative expenses	(857,330)	(390,750)
Finance expenses	(55)	(113)
Profit before tax	159,446	132,448
Income tax expense	(68,220)	(43,536)
Profit for the period	91,226	88,912

Statement of financial position as at 30 June:

	2011 Sh."000"	2010 Sh."000"
Non-current assets at cost:		
Plant, property and equipment	285,785	129,805
Current assets:		
Inventory	327,490	191,039
Trade and other receivables	901,143	323,678
Cash	358	113
	1,514,776	**644,635**
Equity and liabilities:		
Ordinary share capital	1,200	1,200
Retained profits	275,124	183,788
	276,324	184,988
Non-current liabilities	99,095	52,486
Current liabilities	1,139,427	407,161
Total equity and liabilities	**1,514,776**	**644,635**

Additional information:

1. The administrative expenses for the two years comprises

Year ended 30 June	2011 Sh"000"	2010 Sh"000"
Wages	496,235	201,841
Directors emoluments	115,335	45,344
Depreciation	56,997	28,796
Interest payable	14,903	5,572

2. Sh.141, 000,000 of the increase in net book value of property, plant and equipment represents leased motor vehicles. In total, leased motor vehicle represents 79%of the total net book value at 30 June 2011.
3. Trade receivables at 30 June were sh. 802,793,000 while they were sh.332, 528,000 at 30 June 2010.
4. Non-current liabilities are all finance leases. Current liabilities include:

Year ended 30 June	**2011** **Sh"000"**	**2010** **Sh"000"**
Bank overdraft	252,101	39,979
Finance lease liabilities	87,123	40,342

Required:
A report to the management of Biscuit limited with recommendation regarding the overdraft request (16 marks)

(b) Mauzo Limited has a defined benefit plan and prepares financial statements to 31 December every year.
The following information is relevant for the year ended 31 December 2010:
The net pension liability at 31 December 2010 is stated before making any adjustments in respect of actuarial gains or losses arising in the year.
The expected return on plan asset was sh.60million. The unwinding of the discount on the pension liability was sh.30million
The current service cost was sh.45 million. The entity granted additional benefits to existing pensioners that vested immediately and have a present value of sh.10 million. These were not allowed for in the original actuarial assumptions.
The entity paid pension contributions of sh.40 million.
Ignore the deferred tax.
Opening and closing pension liabilities were sh.35 million and 40 million respectively.

Required:
The actuarial gain or loses arising in the year ended 31 December 2010. (4 marks)
(Total: 20 marks)

QUESTION FIVE
The following financial statements relate to holders ltd and its subsidiary company spark ltd and associated company axle ltd.

Income statement for the year ended 31 October 2011:

	Holders ltd **Sh." million"**	**Spark ltd** **Sh. "million"**	**Axle ltd** **Sh." million"**
Revenue	1,700	1,800	930
Cost of sales	(1,156)	(1,206)	(560)
Gross profit	544	594	370
Dividend income	9	-	-
	553	594	370
Distribution cost	(205)	(190)	(100)
Administrative expenses	(245)	(297)	(182)
Profit before tax	103	107	88
Income tax expense	(40)	(50)	(32)
Profit for the period	63	57	56

	Holders ltd	Spark ltd	Axle ltd
Dividends: Paid	(24)	(10)	(12)
Proposed	(30)	(20)	(40)
Retained profit for the year	9	27	4
Retained profit brought forward	244	120	191
Profit carried forward	**253**	**147**	**195**

Statement of financial position as at 31 October 2011

	Holders ltd	**Spark ltd**	**Axle ltd**
Non-current assets at cost:	**Sh." million"**	**Sh."million"**	**Sh." million"**
Plant, property and equipment	1,300	1,145	1,175
Investment in spark ltd	500		
Investment in Axle ltd	200	-	
	2,000	1,145	1,175
Current assets:			
Inventory	170	250	150
Trade and other receivables	190	150	80
Cash and cash equivalent	13	2	210
	2,373	**1,547**	**1,615**
Equity and liabilities:			
Ordinary share capital(sh.10 par value)	1,000	700	600
8% preference share capital	300	-	-
Revaluation surplus	400	100	-
Retained Earnings	253	147	195
	1,953	947	795
Non-current liabilities:			
Loan stock	-	200	300
loan from holders ltd	-	-	150
Deferred tax	20	130	190
	20	330	640
Current liabilities:			
Bank loan	170	-	-
Trade payables	200	250	140
Dividends payables	30	20	40
	400	270	180
	2,373	1,547	1,615

Additional information:

1. On 1 November 2004, Holders ltd acquired 60% of the ordinary shares of spark ltd When the retained earnings of spark ltd were sh.30 million and on 1 November 2006, holders ltd acquired 25% of Axle Ltd.'s share capital. The net assets of Axle ltd on ! November 2006 was valued at 680 million. Holders ltd is able to exercise significant influence over Axle ltd.
2. Included in the receivables of holders ltd is sh.150 million due from spark ltd
3. Holders ltd has not accounted for dividends due from sparks ltd and Axle ltd

Required:

(a) Consolidated income statement for the year ended 31 October 2011 (8 marks)

(b) Consolidated statement of financial position as at 31 October 2011 (12 marks)

(Total: 20 marks)