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CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 21 May 2021. **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 draft statements of financial position relate to P Limited, S Limited and R Limited, all public limited companies, as at 30 June 2020:

	P Limited Sh. "million"	S Limited Sh. "million"	R Limited Sh. "million"
Assets:			
Non-current assets:			
Property, plant and equipment (PPE)	3,920	2,100	910
Investment in S Limited	1,925	-	-
Investment in R Limited	665	-	-
Financial assets	315	210	490
	6,825	2,310	1,400
Current assets:			
Inventories	315	127	218
Trade receivables	170	69	118
Cash and cash equivalents	120	49	84
	605	245	420
Total assets	7,430	2,555	1,820
Equity and liabilities:			
Equity:			
Ordinary shares of Sh.10 each	1,000	700	350
Share premium	400	100	-
Revaluation surplus	95	40	-
Retained earnings	2,435	805	665
	3,930	1,645	1,015
Non-current liabilities:			
8% loan note	1,700	500	475
Deferred tax	655	200	260
	2,355	700	735
Current liabilities:			
Trade payables	570	135	45
Current tax	575	75	25
	1,145	210	70
Total equity and liabilities	7,430	2,555	1,820

The following information is relevant in the preparation of the group financial statements of P Limited:

1. On 1 July 2018, P Limited acquired 80% of the ordinary shares in S Limited. On this date, the fair value of the identifiable net assets of S Limited was Sh.2,100 million. At acquisition, the retained earnings and the revaluation surplus of S Limited were Sh.560 million and Sh.20 million respectively. No new shares have been issued.
   The excess of the fair value of the net assets is due to an increase in the value of non-depreciable land.
2. On 1 July 2017, P Limited had acquired 5% of the ordinary shares of R Limited and treated this investment at fair value through profit or loss in the financial statements to 30 June 2019. On 1 January 2020, P Limited acquired a further 55% of the ordinary shares of R Limited and gained control of the company.

The consideration for the acquisition of the shares in R Limited was as follows:

	Shareholding (%)	Consideration Sh."million"
1 July 2017	5	70
1 January 2020	55	560
	60	630

As at 1 January 2020, the fair value of the 5% equity interest in R Limited was Sh.175 million. The fair value of the identifiable net assets of R Limited as at 1 January 2020 was Sh.910 million and the retained earnings stood at Sh.520 million. The excess of the fair value of the net assets is due to an increase in value of plant with a remaining economic useful life of four years (straight-line depreciation).

3. It is P group's policy to measure the non-controlling interests at fair value. The fair value of non-controlling interests in S Limited was Sh.525 million and the fair value of non-controlling interests in R Limited was Sh.315 million at the respective dates of acquisition.
4. P Limited purchased an item of property, plant and equipment on 1 July 2018 for Sh.300 million. It had an expected useful life of 20 years and is depreciated on the straight-line basis. On 30 June 2019, the item was revalued to Sh.380 million.
   As at 30 June 2020, impairment indicators triggered an impairment review of the PPE whose recoverable amount was Sh.270 million. The only accounting entry posted for the year ended 30 June 2020 was to account for the depreciation based on the revalued amount as at 30 June 2019. P Limited does not make an inter-reserve transfer of excess depreciation arising from the revaluation of the PPE.
5. All goodwill arising from acquisitions has been tested for impairment with no impairment being necessary.
6. Neither S Limited nor R Limited had issued any new shares since P Limited acquired its shares in these two companies.

Required:

(a) Goodwill arising on the acquisition of S Limited and R Limited. (6 marks)

(b) Consolidated statement of financial position for P Group as at 30 June 2020 in accordance with International Financial Reporting Standards (IFRSs). (14 marks)

(Total: 20 marks)

QUESTION TWO

Swara Limited has been suffering great financial stress. The directors of Swara Limited decided that the company should be reconstructed.

The following was the statement of financial position of Swara Limited as at 31 March 2021:

	Sh."000"	Sh."000"
Assets:		
Non-current assets:		
Land and buildings	2,134,200	
Plant and machinery	1,591,200	
Furniture and fixtures	594,600	
Investments	345,000	
Goodwill	390,000	
Patents	240,000	
Preliminary expenses	100,800	5,395,800
Current assets:		
Inventories	975,000	
Trade receivables	858,000	
Cash at bank	271,200	2,104,200
Total assets		7,500,000
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.10 each	3,000,000	
8% preference shares of Sh.50 each	3,600,000	
Profit and loss account	(2,520,000)	4,080,000
Non current liabilities:		
4% debentures		2,400,000
Current liabilities:		
Trade payables	876,000	
Accrued debenture interest	144,000	1,020,000
Total equity and liabilities		7,500,000

Additional information:

1. On 1 April 2021, a new company (Twiga Ltd.), was formed to take over the business of Swara Ltd. Twiga Ltd. was formed with an authorised share capital comprising 600 million ordinary shares of Sh.10 each and 40 million 6% preference shares of Sh.100 each.
2. Preference dividends in Swara Ltd. were two years in arrears.
3. Three ordinary shares of Sh.10 each credited at Sh.5 each in Twiga Ltd. would be issued for each preference share in Swara Ltd. In addition, one fully paid preference share in Twiga Ltd. would be issued for every four preference shares in Swara Ltd. The preference shareholders would, however, pay the balance to make their ordinary shares fully paid.
4. The preference shareholders in Swara Ltd. would forego half of the preference dividends in arrears and would receive fully paid preference shares in Twiga Ltd. for the balance of the arrears of the preference dividends.
5. One ordinary share of Sh.10 each credited at Sh.5 each in Twiga Ltd. would be issued for every two ordinary shares in Swara Ltd. The ordinary shareholders would, however, pay the balance to make their shares fully paid.
6. The debenture holders would receive half of their dues (excluding accrued interest) in 6% debentures of Twiga Ltd. and the balance in fully paid ordinary shares of Twiga Ltd. Interest accrued on debentures would be paid in cash by Twiga Ltd. after taking over Swara Ltd.
7. Trade payables would be taken over by the new company and immediately settled by issue of fully paid ordinary shares of equal value.
8. The assets were transferred to the new company at the following values:

	Sh."000"	
Land and buildings	2,880,000	
Plant and machinery	1,770,000	
Furniture and fixtures	510,000	
Investments	197,400	
Inventories		at book value less 10%
Trade receivables		at book value less 5%
Cash at bank		at book value

9. Twiga Ltd. paid Sh.30 million to Swara Ltd. to pay for dissolution expenses.
10. Twiga Ltd. issued for cash and at par all the remaining ordinary shares and preference shares not issued as part of the settlement of the purchase consideration on acquisition of Swara Ltd.
11. Assume that all the above transactions were completed on 1 April 2021.

Required:

(a) The following accounts in the books of Swara Ltd.:

(i) Realisation account. (4 marks)

(ii) Twiga Ltd. account. (4 marks)

(iii) Ordinary shareholders sundry members account. (3 marks)

(iv) Preference shareholders sundry members account. (3 marks)

(b) Statement of financial position of Twiga Ltd. as at 1 April 2021 after completion of the reconstruction. (6 marks)

(Total: 20 marks)

QUESTION THREE

The following draft group financial statements relate to L Limited, a public limited company:

L Group
Consolidated statement of financial position as at 31 October:

	2020	2019
Assets:	**Sh."million"**	**Sh.".million"**
Non current assets:		
Property, plant and equipment	10,450	10,230
Goodwill	2,310	2,640
Other intangible assets	3,300	5,280
Investment in associate company	1,760	-
	17,820	18,150

	Sh."million"	Sh."million"
Current assets:		
Inventories	3,410	4,180
Trade receivables	2,750	3,960
Cash and cash equivalents	10,230	7,810
	16,390	15,950
Total assets	34,210	34,100
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.10 each	18,150	13,750
Revaluation surplus	600	440
Retained earnings	7,832	5,698
	26,582	19,888
Non-controlling interest	1,980	1,430
Total equity	28,562	21,318
Non-current liabilities:		
Long-term borrowings	291	1,056
Deferred tax	770	682
	1,061	1,738
Current liabilities:		
Trade payables	3,410	7,942
Current tax	1,078	3,036
Accrued interest	99	66
	4,587	11,044
Total equity and liabilities	34,210	34,100

L Group
Consolidated statement of comprehensive income
for the year ended 31 October 2020

	Sh."million"
Sales revenue	27,236
Cost of sales	(21,692)
Gross profit	5,544
Other income	652
Distribution costs	(1,100)
Administrative expenses	(990)
Operating profit	4,106
Finance costs	(242)
Share of profit of associate company	352
Profit before tax	4,216
Income tax expense	(1,012)
Profit for the year	3,204
Other comprehensive income:	
Revaluation of property, plant and equipment	176
Total comprehensive income for the year	3,380
Profit for the year:	
Attributable to the owners of the parent	2,522
Attributable to the non-controlling interests	682
	3,204
Total comprehensive income for the year:	
Attributable to the owners of the parent	2,698
Attributable to the non-controlling interests	682
	3,380

Additional information:

1. On 1 January 2020, L Limited acquired 75% of the ordinary share capital of G Limited for Sh.660 million. The fair values of the identifiable assets and liabilities of G Limited at the date of acquisition were as set out below:

	Sh."million"
Property, plant and equipment	308
Inventories	132
Trade receivables	66
Cash and cash equivalents	44

	Sh."million"
Trade payables	(88)
Current tax	(22)
Net assets at acquisition	440

L group measures the non-controlling interests at their proportionate share of net assets at the date of acquisition.

2. The property, plant and equipment (PPE) comprises the following:

	Sh."million"
Carrying amount as at 1 November 2019	10,230
Additions at cost including assets acquired in G Limited	1,760
Gains on property revaluation	176
Disposals	(1,078)
Depreciation	(638)
Carrying amount as at 31 October 2020	10,450

The disposal proceeds of PPE were Sh.1,730 million.
The gain on disposal is shown as other income.
It is the group's policy to make inter-reserve transfer of excess depreciation upon revaluation of PPE to reflect realisation of revaluation surplus.

3. L Limited purchased a 40% interest in an associate company for cash on 1 November 2019. The net assets of the associate company at the date of acquisition were Sh.6,160 million. The associate company made a profit after tax of Sh.880 million and paid a dividend of Sh.220 million out of these profits in the year ended 31 October 2020.
4. An impairment test carried out on 31 October 2020 revealed that goodwill and other intangible assets were impaired.
5. All group companies declared and paid dividends to the shareholders during the year ended 31 October 2020.
6. Ignore deferred tax consequences on the acquisition of the investment in the subsidiary and on the revaluation of PPE.

Required:
Consolidated statement of cash flows for L Group for the year ended 31 October 2020 using the indirect method in accordance with International Accounting Standard (IAS) 7 "Statement of Cash Flows". **(Total: 20 marks)**

QUESTION FOUR

(a) Haraka Limited manufactures plastic water tanks. On 31 December 2020, its closing inventory consisted of 950 kilogrammes of plastic resin raw material and 250 completed plastic water tanks.

Additional information:

1. The purchase price of plastic resin was Sh.300 per kilogramme throughout the year to 31 December 2020. Delivery costs were an additional Sh.50 per kilogramme. Haraka Limited has a policy of always keeping plenty of plastic resin in inventory as its supply can be unreliable. However, close to the year-end, the price of plastic resin collapsed due to market oversupply. The purchase price of Haraka Limited's raw material is currently Sh.210 per kilogramme plus the Sh.50 per kilogramme delivery charge. The existing inventory of plastic resin can be sold in the market for Sh.180 per kilogramme net of all costs.
2. Each tank requires 10 kilogrammes of plastic resin to manufacture. Each plastic tank incurs Sh.2,500 in conversion costs (labour and overheads). Haraka Limited sells each tank at Sh.10,000. It is expected that this price will drop to Sh.9,000 per tank as a result of the fall in the market price of plastic resin. Each completed tank sold by Haraka Limited incurs a Sh.600 selling and distribution cost.

Required:

(i) Discuss the principles for determining the "Net Realisable Value" of inventory under IAS 2 (Inventories). (6 marks)

(ii) Calculate the value of closing inventory in the books of Haraka Limited as at 31 December 2020 by applying the principles of IAS 2. (8 marks)

(b) Naivasha Limited issued 500 convertible loan notes on 1 January 2018 at par. Each loan note is redeemable in three years' time at its par value of Sh.2,000 per note. Alternatively, each note can be converted at the maturity date (1 January 2021) into 125, Sh.10 ordinary shares.

The loan notes pay interest annually in arrears at a coupon interest rate (based on nominal value) of 6%. The prevailing market interest rate for three-year loan notes without conversion rights is 9%.

Required:
Prepare extracts of financial statements for Naivasha Limited for each of the years ended 31 December 2018, 2019 and 2020. (6 marks)
(Total: 20 marks)

QUESTION FIVE

(a) The IASB's Conceptual Framework for Financial Reporting sets out the concepts that underlie the preparation and presentation of financial statements for external users.

Required:
Discuss the aims of the Conceptual Framework clearly stating how a conflict between it and a particular accounting standard could be resolved. (6 marks)

(b) Explain how the following might address the limitations of financial reporting and improve the usefulness of the annual report:

(i) Sustainability reporting. (4 marks)

(ii) Integrated reporting. (4 marks)

(c) The objective of International Public Sector Accounting Standard (IPSAS) 39 "Employee Benefits" is to prescribe the accounting treatment and disclosure for employee benefits in public sector entities.

Required:
With regard to IPSAS 39 "Employee Benefits", describe the elements of the remeasurement component of the net defined benefit liability (asset) and indicate how the treatment of the remeasurement component under IPSAS 39 compares with that of commercial sector entities under International Accounting Standard (IAS) 19 "Employee Benefits". (6 marks)
(Total: 20 marks)

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