



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

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

- 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.
- 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	<u>55</u>	<u>560</u>
	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:

Assets:	Sh. "000"	Sh. "000"
<b>Non-current assets:</b>		
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	<u>100,800</u>	5,395,800
<b>Current assets:</b>		
Inventories	975,000	
Trade receivables	858,000	
Cash at bank	<u>271,200</u>	<u>2,104,200</u>
Total assets		<u>7,500,000</u>
<b>Equity and liabilities:</b>		
<b>Equity:</b>		
Ordinary shares of Sh.10 each	3,000,000	
8% preference shares of Sh.50 each	3,600,000	
Profit and loss account	<u>(2,520,000)</u>	4,080,000
<b>Non current liabilities:</b>		
4% debentures		2,400,000
<b>Current liabilities:</b>		
Trade payables	876,000	
Accrued debenture interest	<u>144,000</u>	<u>1,020,000</u>
Total equity and liabilities		<u>7,500,000</u>

**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"
<b>Non current assets:</b>		
Property, plant and equipment	10,450	10,230
Goodwill	2,310	2,640
Other intangible assets	3,300	5,280
Investment in associate company	<u>1,760</u>	<u>-</u>
	<u>17,820</u>	<u>18,150</u>

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

**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
<b>Other comprehensive income:</b>	
Revaluation of property, plant and equipment	176
Total comprehensive income for the year	<u>3,380</u>
<b>Profit for the year:</b>	
Attributable to the owners of the parent	2,522
Attributable to the non-controlling interests	682
	<u>3,204</u>
<b>Total comprehensive income for the year:</b>	
Attributable to the owners of the parent	2,698
Attributable to the non-controlling interests	682
	<u>3,380</u>

**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

	<b>Sh. "million"</b>
Trade payables	(88)
Current tax	<u>(22)</u>
Net assets at acquisition	<u>440</u>

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:

	<b>Sh. "million"</b>
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	<u>(638)</u>
Carrying amount as at 31 October 2020	<u>10,450</u>

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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**CPA PART III SECTION 6**

**ADVANCED FINANCIAL REPORTING**

**MONDAY: 30 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) International Financial Reporting Standard (IFRS) 6 “Exploration for and Evaluation of Mineral Resources” requires entities to assess exploration and evaluation assets for impairment. The recognition criteria for impairment are different from those in International Accounting Standard (IAS) 36 “Impairment of Assets”.

**Required:**

With reference to International Financial Reporting Standard (IFRS) 6, evaluate the circumstances under which impairment tests on exploration and evaluation assets are required. (6 marks)

- (b) Professional accountants are expected to follow the guidance contained in the fundamental principles in the ethical code in all their courses of action. The ethical code sets out five fundamental principles of ethics comprising: Integrity, objectivity, professional competence and due care, confidentiality and professional behaviour; the spirit of which must be complied with.

**Required:**

With reference to the ethical code, discuss three circumstances that may potentially threaten the professional accountant’s compliance with the fundamental principles of ethics. (6 marks)

- (c) ABC Ltd. owns a machine which originally cost Sh.10,000,000. The accumulated depreciation associated with the machine was Sh.2,500,000 as at 31 December 2019. A mechanical engineer assessed the machine in early January 2020. The engineer’s report stated that similar damaged machines had sold for Sh.1,000,000 in the recent past. In addition, due to the machine’s unique nature, significant advertising costs of Sh.100,000 would be incurred to find a buyer. The machine was not covered by insurance.

A power surge during the year ended 31 December 2019 reduced the machine’s production capacity and shortened its expected life. ABC Ltd.’s management accountants estimated that the damaged machine would generate cash flows of Sh.3,000,000 per annum over an expected remaining useful life of 3 years. ABC Ltd.’s cost of capital is 9%. No impairment of the machine had been recorded in the accounts.

**Required:**

In the context of IAS 36 (Impairment of Assets), outline the necessary accounting treatment of the machine given the above information.

**Note:** The present value interest factor of an annuity of Sh.1 per year at 9% for 3 years is 2.5313. (4 marks)

- (d) Discuss two benefits that an organisation might derive from providing social and environmental reports. (4 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) The objective of International Public Sector Accounting Standard (IPSAS) 18 “Segment Reporting” is to establish principles for reporting financial information by segments. The disclosure of this information will help users of the financial statements to better understand the entity’s past performance, identify the resources allocated to support the major activities of the entity, enhance the transparency of financial reporting and enable the entity to better discharge its accountability duties.

**Required:**

In the context of International Public Sector Accounting Standard (IPSAS) 18 "Segment Reporting", explain how public sector entities identify segments that should be reported separately and indicate how this differs from reportable segments for commercial sector entities under International Financial Reporting Standard (IFRS) 8 "Operating Segments".

(4 marks)

- (b) H Limited is the parent entity of a group of companies with two subsidiaries, S Limited and R Limited. Both subsidiaries have been owned for a number of years.

The following statements of profit or loss and other comprehensive incomes relate to the group of companies:

**Statement of profit or loss and other comprehensive incomes for the year ended 30 April 2020:**

	<b>H Limited</b>	<b>S Limited</b>	<b>R Limited</b>
	<b>Sh. "million"</b>	<b>Sh. "million"</b>	<b>Sh. "million"</b>
Revenue	4,275	2,515	1,730
Cost of sales	<u>(2,735)</u>	<u>(1,445)</u>	<u>(1,010)</u>
Gross profit	1,540	1,070	720
Distribution costs	(305)	(195)	(90)
Administrative expenses	<u>(370)</u>	<u>(235)</u>	<u>(120)</u>
Profit from operations	865	640	510
Finance costs	<u>(45)</u>	<u>(40)</u>	<u>(30)</u>
Profit before tax	820	600	480
Income tax expense	<u>(160)</u>	<u>(120)</u>	<u>(100)</u>
Profit after tax for the year	660	480	380
Other comprehensive income:			
Gain on property revaluation	<u>150</u>	<u>80</u>	<u>-</u>
Total comprehensive income	<u>810</u>	<u>560</u>	<u>380</u>

**Additional information:**

- On 1 May 2017, H Limited acquired 75% of the ordinary shares of S Limited, a public limited entity. The purchase consideration was cash of Sh.560 million and the fair value of the identifiable net assets of S Limited was Sh.400 million as at that date. The fair value of non-controlling interest in S Limited as at the date of acquisition was Sh.240 million. H Limited wishes to use the "full goodwill" method for all acquisitions. The ordinary share capital and retained profit of S Limited as at the acquisition date were Sh.100 million and Sh.200 million respectively and there were no other reserves. The excess of the fair value of the identifiable net assets at acquisition is due to an increase in fair value of plant, which is depreciated on a straight-line basis and had a five-year remaining life as at the date of acquisition.
- H Limited had acquired 80% of the ordinary shares of R Limited, on 1 May 2016. The purchase consideration was cash of Sh.600 million. R Limited's identifiable net assets had a fair value of Sh.550 million which was equal to their carrying amounts. The non-controlling interest in R Limited had a fair value of Sh.150 million at the date of acquisition.
- On 1 November 2019, H Limited disposed of 30% of the ordinary shares of R Limited for a consideration of Sh.375 million. R Limited's identifiable net assets were Sh.675 million and the non-controlling interest of R Limited had a carrying value of Sh.175 million at the date of disposal. The remaining equity interest in R Limited held by H Limited had a fair value of Sh.575 million on 1 November 2019.

After disposal, H Limited would exercise joint control over R Limited. The profits and losses of R Limited are deemed to accrue evenly over the year.

- H Limited sold inventory to both S Limited and R Limited at a price of Sh.150 million and Sh.45 million respectively, in the month of October 2019. H Limited sells goods at a gross profit margin of 20% to group companies and third parties. At the year end, half of the inventory sold to S Limited remained unsold but the entire inventory sold to R Limited had been transferred to third parties.
- Goodwill arising on acquisitions has been tested for impairment annually and as at 30 April 2019, goodwill on acquisition of S Limited had reduced in value by 15% and as at 30 April 2020, had lost a further 5% of its original value.

No impairment had occurred in respect of goodwill on acquisition of R Limited and the interest in R Limited.



**Required:**

- (i) Gain or loss arising on disposal of R Limited to be presented on the consolidated statement of profit or loss and other comprehensive incomes. (4 marks)
- (ii) Consolidated statement of profit or loss and other comprehensive incomes for H Group for the year ended 30 April 2020. (12 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Madini Ltd. issued share options to its directors on 1 January 2019. The options have a vesting period of 10 years and had a fair value of Sh.20,000,000 as at the date of issue. In order to be eligible to exercise the share options, the directors are required to remain in the employment of Madini Ltd. over the entire vesting period.

Actuaries have estimated that 20% of the directors who have received the share options will leave the employment of Madini Ltd. over the vesting period. The financial year end of Madini Ltd. is 31 December.

**Required:**

Advise the management of Madini Ltd. on how to account for the share options in the financial statements for the year ended 31 December 2019. (6 marks)

- (b) Uzamatt Ltd. is a long-established retail entity which has been operating through a network of retail outlets and an online store. In recent years, the business has seen its revenue from the online store grow strongly, and that from retail outlets decline significantly. On 25 June 2019, the board of Uzamatt Ltd. decided to close the retail network at the financial year end of 31 December 2019 and put the buildings up for sale on that date.

The directors of Uzamatt Ltd. are seeking advice regarding the treatment of the buildings in the statement of financial position, as well as the treatment of the trading results of the retail division for the year ended 31 December 2019. The following figures have been provided as at 31 December 2019:

	Sh. "million"
Carrying value of buildings	2,000
Fair value less costs to sell of the buildings	1,720
Other expected costs of closure	390

**Trading results:**

1. Year ended 31 December 2019:

	Online store Sh. "million"	Retail outlet Sh. "million"
Revenue	3,900	900
Cost of sales	(1,300)	(700)
Gross profit	2,600	200
Operating costs	(1,000)	(500)
Profit before tax	1,600	(300)

2. Year ended 31 December 2018:

	Online store Sh. "million"	Retail outlet Sh. "million"
Revenue	3,200	1,200
Cost of sales	(1,100)	(900)
Gross profit	2,100	300
Operating costs	(800)	(500)
Profit before tax	1,300	(200)

**Required:**

In the context of IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations);

- (i) Discuss the conditions which must be present in order to classify a non-current asset as being "held for sale". (6 marks)
- (ii) Draft the statement of profit or loss for Uzamatt Ltd. for the year ended 31 December 2019, together with the comparatives for 2018, taking the above information into account. (8 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) Distinguish between the two types of joint arrangement described by IFRS 11 (Joint Arrangements). (4 marks)
- (b) Dynamic Ltd. has been reporting losses for the past few years. The creditors and shareholders have come up with a capital re-organisation plan aimed at putting the company back on the path of profitability.

The following is the summarised statement of financial position of the company as at 30 June 2019:

	Sh. "million"	Sh. "million"
<b>Assets:</b>		
<b>Non-current assets:</b>		
Tangible assets		3,040
Intangible assets		<u>1,872</u>
		4,912
<b>Current assets:</b>		
Inventory	2,720	
Accounts receivable	3,104	
Investment (market value Sh.896 million)	<u>352</u>	6,176
Total assets		<u>11,088</u>
<b>Capital and liabilities:</b>		
<b>Share capital:</b>		
240 million ordinary shares of Sh.20 each		4,800
6%, 128 million cumulative preference shares of Sh.20 each		<u>2,560</u>
		7,360
<b>Revenue reserve:</b>		
Accumulated losses		(2,624)
<b>Non-current liabilities:</b>		
6% debentures		<u>2,400</u>
		7,136
<b>Current liabilities:</b>		
Accounts payable	1,600	
Bank overdraft	1,248	
Debenture interest payable	144	
Accruals	320	
Directors' loans	<u>640</u>	
		3,952
Total capital and liabilities		<u>11,088</u>

The court approved the scheme of reorganisation and it was to take effect on 1 July 2019. Details of the approved scheme were as follows:

1. Tangible assets comprised freehold property and plant valued at Sh.2,720 million and Sh.320 million respectively while the intangible assets comprised patents and goodwill valued at Sh.976 million and Sh.896 million respectively.

Patents and goodwill are to be written off. An amount of Sh.480 million is to be written off inventory and Sh.374.4 million is to be provided for bad debts. The remaining freehold property is to be revalued at Sh.2,480 million. The investment was sold at the prevailing market value.

2. The 6% preference dividends are four years in arrears of which three-quarters are to be waived and ordinary shares are to be allocated at par for the balance.
3. The 6% preference shares are to be written down to Sh.15 each and the existing ordinary shares to Sh.4 each.

All the ordinary shares are to be consolidated into shares of Sh.20 each. The rate of dividend on preference shares is to be increased to 10%.

4. There are capital commitments amounting to Sh.2,400 million which are to be cancelled, on payment of 3½% of the contract price as a penalty.
5. The 6% debenture holders were to have their interest paid in cash and to take over part of the freehold property (book value Sh.640 million) at a valuation of Sh.768 million in part payment of their holding. The 6% debenture holders are also to provide additional cash of Sh.832 million secured by a floating charge on the company's assets at an interest rate of 12% per annum.
6. The directors were to accept settlement of their loans as to 90% thereof by allotment of ordinary shares at par and as to 5% in cash. The balance of 5% was to be waived.

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- 7. The trade payables were to be paid Sh.0.40 in every shilling to maintain and obtain an extension of the credit period.
- 8. The bank has sanctioned an overdraft limit of Sh.40 million to provide working capital.

**Required:**

- (i) The capital reduction account to record the scheme of capital re-organisation. (8 marks)
- (ii) The statement of financial position of Dynamic Ltd. as at 1 July 2019 immediately after effecting the scheme of reorganisation. (8 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) On 1 January 2019, Dodoma Ltd. issued 1,000,000 bond instruments with a face value of Sh.100, at a market price of Sh.95. Bond brokers charged fees totalling Sh.1,800,000 in relation to the bond issue. The bonds carry a coupon rate of 5% and are redeemable in 3 years at face value. Dodoma Ltd. wishes to account for the bonds using the amortised cost method as per IFRS 9 (Financial Instruments).

However, there is some confusion about how the bonds should be accounted for. The cash received from the bond issue of Sh.95,000,000 has been recognised as a non-current liability. The broker fees of Sh.1,800,000 were deducted from the carrying amount of the non-current liability. The coupon payment of Sh.5,000,000 has been expensed in arriving at the profit before tax.

The effective rate of interest is 7.62%. The coupon interest payments are made at the end of the year.

**Required:**

Demonstrate how the bond issue should be accounted for in the books of Dodoma Ltd. for the year ended 31 December 2019. (10 marks)

- (b) On 1 January 2019, Kamili Ltd. commenced a defined benefit pension plan for its employees. Under the pension plan, Kamili Ltd. has an obligation to provide staff with agreed post-employment benefits. Kamili Ltd. carries the actuarial and investment risk associated with the pension scheme.

The following information has been compiled for the financial year ended 31 December 2019:

	<b>Sh. "000"</b>
Interest income on plan assets	16,500
Employer contributions to plan	550,000
Current service cost	600,000
Interest on plan liability	18,000
Fair value of plan assets (31 December 2019)	580,000
Present value of plan obligations (31 December 2019)	620,000

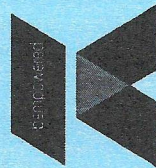
Kamili Ltd's accountant was not sure which accounting standard to apply when accounting for the pension scheme. The only adjustment made to account for the scheme was to expense the company's contribution of Sh.55,000,000 for the financial year ended 31 December 2019 in the statement of profit or loss and other comprehensive incomes and to credit the cash account.

**Required:**

Evaluate the treatment Kamili Ltd.'s accountant has given the above issues and offer any correction, if and where necessary. Use journal entries. (10 marks)

**(Total: 20 marks)**

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CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

THURSDAY: 28 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) International Financial Reporting Standards (IFRSs) are developed by the International Accounting Standards Board (IASB) through a formal system of due process and broad international consultation involving accountants, financial analysts, financial statements users and regulatory bodies from around the world.

The overall agenda of the IASB will initially be set by discussion with the IFRS Advisory Council.

Required:

Explain the steps that are followed in the process of setting International Financial Reporting Standards.

(4 marks)

- (b) Many countries have adopted international financial reporting standards (IFRSs) issued by the International Accounting Standards Board (IASB). However, due to local requirements and other challenges, some countries still prefer to use their own local standards.

Required:

(i) Summarise five reasons why reporting entities would prefer to adopt IFRSs.

(5 marks)

(ii) Identify five challenges that reporting entities are likely to encounter while implementing IFRSs.

(5 marks)

- (c) Integrated reporting (IR) is a concept that urges reporting entities to focus on the value creators within their business with a focus on the longer-term success of a business rather than the short-term focus on results.

Required:

Explain three objectives of integrated reporting (IR).

(6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) International Accounting Standard (IAS) 21: "The Effects of Changes in Foreign Exchange Rates" requires the transactions carried out by an entity in foreign currencies and the financial statements of a foreign operation (foreign subsidiary) to be translated into the presentation currency of the reporting entity.

Required:

In the context of the International Accounting Standard (IAS) 21, explain the treatment of exchange differences (gains/losses) arising on translation, clearly distinguishing the treatment in the individual entity's financial statements and in the consolidated financial statements.

(6 marks)

- (b) H Limited, a public limited company whose functional currency is the Kenya Shilling (Ksh.), operates in the mining sector and has recently acquired a foreign subsidiary, B Limited. The functional currency of B Limited is the Krone (Kr.).

The following draft statements of financial position relate to the two entities as at 30-September 2019:

Table with 3 columns: Assets, H Limited Ksh. "million", B Limited Kr. "million". Rows include Non-current assets, Property, plant and equipment, and Investment in B Limited.

	H Limited Ksh. "million"	B Limited Kr. "million"
<b>Current assets:</b>		
Inventories	1,566	2,605
Trade receivables	1,401	2,000
Cash and cash equivalents	<u>1,238</u>	<u>1,399</u>
	<u>4,205</u>	<u>6,004</u>
Total assets	<u>12,050</u>	<u>13,830</u>
<b>Equity and liabilities:</b>		
<b>Equity:</b>		
Ordinary share capital	2,875	3,640
Share premium	1,437	1,820
Retained earnings	3,350	3,640
Total equity	<u>7,662</u>	<u>9,100</u>
<b>Non-current liabilities:</b>		
10% loan note	450	1,310
Deferred tax	<u>569</u>	<u>1,600</u>
	<u>1,019</u>	<u>2,910</u>
<b>Current liabilities:</b>		
Trade payables	2,498	1,238
Current tax	<u>871</u>	<u>582</u>
	<u>3,369</u>	<u>1,820</u>
Total equity and liabilities	<u>12,050</u>	<u>13,830</u>

**Additional information:**

- On 1 October 2018, H Limited acquired 80% of the ordinary shares of B Limited when B Limited's retained earnings were 3,100 million Kroner.

The fair value of the identifiable net assets of B Limited on 1 October 2018 was 9,008 million Kroner. The excess of the fair value over the carrying amount of net assets is due to an increase in the value of land.

- H Limited wishes to use the "full goodwill" method and the fair value of the non-controlling interest in B Limited as at 1 October 2018 was 4,550 million Kroner. There has been no impairment of goodwill since acquisition.
- On 1 October 2018, H Limited issued a 10% loan note amounting to Ksh. 40 million to B Limited repayable in ten years' time. Interest on the loan note has been correctly accounted for by both entities. However, the loan note is still recorded in the financial statements of B Limited at the amount obtained by applying the rate of exchange at the date of the issue.
- H Limited expanded its overseas operations and on 1 April 2019, acquired an overseas building with a fair value of 715 million Kroner. In exchange for the building, H Limited paid the seller with land which it had held for long term capital appreciation. The carrying amount of the land was Ksh.100 million but it had an open market value of Ksh.140 million. H Limited has only recorded the transfer of Ksh.100 million from investment properties to property, plant and equipment. The transaction has commercial substance. H Limited has a policy of depreciating buildings over a period of 35 years and follows the revaluation model. As a result of a surge in the market, it is estimated that the fair value of the overseas building was 800 million Kroner as at 30 September 2019.
- The following foreign exchange rates are relevant to the preparation of consolidated financial statements:

	Krones to Ksh.1
1 October 2018	6.0
1 April 2019	5.5
30 September 2019	5.0
Average for the year to 30 September 2019	5.8

**Required:**

Consolidated statement of financial position for the H group as at 30 September 2019 in accordance with International Financial Reporting Standards. Round your figures to the nearest Ksh. "million". (14 marks)

(Total: 20 marks)

### QUESTION THREE

(a) Explain two factors which encourage reporting entities to disclose social and environmental information. (4 marks)

(b) (i) On 1 January 2009, the government built a market at a cost of Sh.150 million. The market was expected to provide service for 40 years. On 31 December 2018 after ten years of use, a fire caused severe structural damage to the market. Due to safety concerns, the market was closed for repairs that cost Sh.106.5 million. These repairs were made to restore the market to occupiable condition. The current cost of a new market is Sh.300 million.

**Required:**

Impairment loss to be recognised for the market using the cost restoration approach. (4 marks)

(ii) On 1 January 2014, the government acquired a modern software to enhance service delivery at a cost of Sh.350 million. The software had an estimated useful life of 8 years and its benefits would accrue evenly on a straight line basis over the software's useful life. As at 31 December 2018, usage of the software had dropped to 15% of its originally anticipated demand. A software to replace the remaining service potential of the existing software would cost Sh.150 million.

**Required:**

Determine the impairment loss to be recognised for the software using the depreciated replacement cost approach. (4 marks)

(c) On 1 January 2014, Wale Ltd. granted its 500 employees options to buy 1,000 shares each from the company on condition that they continued working for the company until 31 December 2016.

During the year 2014, 35 employees left and it was estimated that a further 60 would leave in years 2015 and 2016.

During the year 2015, 40 employees left and it was estimated that a further 25 employees would leave in year 2016.

During the year 2016, 22 employees left.

As at 31 December 2016, 150 employees exercised their options. Another 140 employees exercised their options on 31 December 2017 and the remaining 113 exercised their options as at 31 December 2018.

The terms of the options were that the company would pay for the shares on behalf of the employees. The fair values of the shares were as follows:

31 December	Fair value per share (Sh)
2014	72
2015	77.5
2016	91
2017	107
2018	125

**Required:**

The amounts to be recognised in the income statement as an expense for each of the 5 years and the liability to be recognised in the statement of financial position as at 31 December for each year. (8 marks)

(Total: 20 marks)

### QUESTION FOUR

The following financial statements relate to Makongeni Group for the year ended 31 October 2019:

	Makongeni Group: Consolidated statement of financial position as at 31 October:	
	2019 Sh."million"	2018 Sh."million"
<b>Assets:</b>		
<b>Non-current assets:</b>		
Property, plant and equipment	10,180	6,500
Goodwill	7,720	7,400
Investment in associate	<u>2,480</u>	<u>2,160</u>
	<u>20,380</u>	<u>16,060</u>

	2019 Sh. "million"	2018 Sh. "million"
<b>Current assets:</b>		
Inventories	1,880	1,740
Trade receivables	1,560	1,320
Short-term investments	300	200
Cash and bank balances	<u>540</u>	<u>360</u>
Total assets	<u>4,280</u>	<u>3,620</u>
<b>Equity and liabilities:</b>		
<b>Equity:</b>		
Ordinary share capital (Sh.10 par value)	6,000	6,000
Revaluation surplus	3,000	2,100
Retained earnings	<u>7,020</u>	<u>4,340</u>
Non-controlling interest	16,020	12,440
Total equity	<u>1,240</u>	<u>1,280</u>
	<u>17,260</u>	<u>13,720</u>
<b>Non-current liabilities:</b>		
Bank loans	2,000	1,200
Deferred tax	<u>600</u>	<u>420</u>
	<u>2,600</u>	<u>1,620</u>
<b>Current liabilities:</b>		
Trade payables	3,200	2,900
Current tax	<u>1,600</u>	<u>1,440</u>
	<u>4,800</u>	<u>4,340</u>
Total equity and liabilities	<u>24,660</u>	<u>19,680</u>

**Makongeni Group:**

**Consolidated statement of comprehensive income for the year ended 31 October 2019**  
Sh. "million"

Revenue	8,360
Operating expenses	<u>(4,620)</u>
Profit from operations	3,740
Gain on disposal of subsidiary	400
Finance costs	(140)
Share of profit of associate	<u>460</u>
Profit before tax	4,460
Income tax expense	<u>(900)</u>
Profit after tax for the year	3,560
<b>Other comprehensive income:</b>	
Revaluation gain on property	800
Other comprehensive income of associate	<u>200</u>
Total comprehensive income	<u>4,560</u>
<b>Profit for the year attributable to:</b>	
Owners of the parent	3,180
Non-controlling interests	<u>380</u>
	<u>3,560</u>
<b>Total comprehensive income for the year attributable to:</b>	
Owners of the parent	4,080
Non-controlling interests	<u>480</u>
	<u>4,560</u>

**Additional information:**

- During the year, Makongeni Limited acquired 80% of the ordinary share capital of Razak Limited, paying a cash consideration of Sh.6,000 million.

The non-controlling interest holding was measured at its fair value of Sh.1,360 million at the date of acquisition.

The fair values of the net assets of Razak Limited as at the date of acquisition comprised the following:

	Sh. "million"
Property, plant and equipment	5,120
Inventories	600
Trade receivables	960
Cash and cash equivalents	320
Trade payables	(880)
Tax payables	(160)
	<u>5,960</u>

2. During the year, Makongeni Limited also disposed of its entire 60% ordinary shareholding in Salama Limited. The subsidiary had been acquired several years ago for a cash consideration of Sh.2,400 million.

The non-controlling interest holding was measured at its fair value of Sh.1,280 million as at the date of acquisition and the fair value of Salama Limited's net assets was Sh.2,920 million.

Goodwill on acquisition of Salama Limited had not suffered any impairment.

At the date of disposal, the net assets of Salama Limited had carrying values in the consolidated statement of financial position as set out below:

	Sh. "million"
Property, plant and equipment	2,900
Inventories	660
Trade receivables	480
Cash and cash equivalents	200
Trade payables	(320)
	<u>3,920</u>

3. The short term investments are readily convertible into known amounts of cash and there is an insignificant risk of their fair value changing.
4. Depreciation of Sh.1,540 million was charged during the year. Plant with a carrying amount of Sh.1,000 million was sold for Sh.1,100 million. The gain on disposal was recognised in operating profit.

Some properties were revalued during the year resulting in revaluation gain of Sh.800 million being reported.

Ignore deferred tax on revaluation of property, plant and equipment.

**Required:**

Consolidated statement of cash flows for the Makongeni Group for the year ended 31 October 2019 using the indirect method in accordance with International Accounting Standard (IAS) 7 "Statement of Cash Flows". (20 marks)

**QUESTION FIVE**

- (a) Dakika Ltd. has prepared its consolidated financial statements for the year to 30 September 2019, extracts of which are shown below. Also provided below are extracts of the consolidated financial statements for the year to 30 September 2018.

Year ended 30 September:	2019 Sh. "000"	2018 Sh. "000"
Profit before interest and tax	8,830	7,012
Finance cost	1,045	987
Tax charge	1,718	1,264
Ordinary dividends paid	120	100
Preference dividends paid	60	60
Profit attributable to non-controlling interest (NCI)	180	160

You have also obtained the following information in respect of the company's share capital:

- Ordinary share capital as at 1 October 2017 was Sh.15,000,000 made up of shares of Sh.5 par value.
- Dakika Ltd. issued some 500,000 ordinary shares at full market value on 1 January 2018.
- Dakika Ltd. also made a rights issue of 2 new ordinary shares for every 10 ordinary shares held as at 1 April 2019. The rights price per share was Sh.42.5 (market value per share as at the same date was Sh.48).
- Dakika Ltd. also had 1,000,000 6%, Sh.10 par value non-redeemable preference shares as at 1 October 2018.



**Required:**

- (i) The basic earnings per share (EPS) for the year ended 30 September 2018. (4 marks)
- (ii) The basic earnings per share (EPS) for the year ended 30 September 2019. (6 marks)

(b) Mafuta Limited had a deferred tax liability as at 1 October 2018 of Sh.400 million.

For the purposes of preparing the financial statements for the year ended 30 September 2019, the following additional information is available:

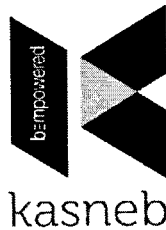
1. The company has available for sale financial assets with a carrying amount of Sh.80 million and financial assets at fair value through profit and loss of Sh.40 million. Both financial assets had reported losses in fair value of Sh.8 million each as at 30 September 2019.
2. Inventory is shown at the lower of cost and net realisable value. The cost is Sh.3,200 million while the net realisable value is Sh.3,120 million.
3. Receivables had a carrying amount of Sh.2,000 million after making an allowance for doubtful debts of Sh.80 million and an exchange gain of Sh.160 million (unrealised). Both the allowance and the exchange gain are not allowed for tax purposes.
4. Trade and other payables are stated at Sh.3,600 million after making provision for discount of Sh.40 million.
5. Property, plant and equipment has a carrying amount of Sh.4,800 million and a tax base of Sh 4,000 million. Some land and buildings were revalued upwards by Sh.200 million during the year ended 30 September 2019.
6. Intangible assets consisting of trade licences being amortised over five years had a carrying amount of Sh.240 million. This was allowed for tax purposes in full two years ago.
7. Assume a tax rate of 30%.

**Required:**

- (i) The relevant temporary differences. (8 marks)
- (ii) Journal entry to record changes in the deferred tax liability. (2 marks)

**(Total: 20 marks)**

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CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 24 May 2019.

Time Allowed: 3 hours.

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

**QUESTION ONE**

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

**Required:**

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

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

**Required:**

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

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

**Required:**

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

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

**(Total: 20 marks)**

**QUESTION TWO**

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

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

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

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

**Additional information:**

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

**Required:**

- Determine the amount of goodwill arising on acquisition of S Ltd. and A Ltd. after the impairment review. (6 marks)
  - Consolidated statement of financial position of G Ltd. group as at 30 September 2018 in accordance with International Financial Reporting Standards (IFRSs). (14 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- With reference to International Accounting Standard (IAS) 19 "Employee Benefits", briefly explain the accounting treatment of the defined benefit pension surplus (plan asset) in the financial statements of an employer. (4 marks)
  - W Limited, a public limited company, operates a defined benefit pension plan for its employees. The present value of the future benefit obligations as at 1 January 2018 was Sh.3,080 million and the fair value of the plan assets as at the same date was Sh.2,860 million.

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

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

**Additional information:**

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

**Required:**

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

(8 marks)

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

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

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

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

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

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

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

**Required:**

A capital reduction account for Matatizo Limited after completion of the internal reconstruction.

(8 marks)

**(Total: 20 marks)****QUESTION FOUR**

- (a) Briefly explain the various classifications of financial instruments as per IFRS 9 (Financial Instruments). (6 marks)
- (b) Tewa Ltd. has provided the following extracts from its income statements for the years ended 31 December 2017 and 31 December 2018:

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

**Capital structure includes:**

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

**Additional information:**

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

**Required:**

- The basic earnings per share (EPS) for the years 2017 and 2018. (6 marks)
- The diluted EPS for the years 2017 and 2018. (8 marks)

**(Total: 20 marks)****QUESTION FIVE**

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

<b>Tembea Group</b>		
<b>Consolidated income statement for the year ended 31 March 2019</b>		
	Sh."000"	Sh."000"
Revenue		74,364
Cost of sales		<u>(56,680)</u>
Gross profit		17,684
Other incomes: Investment income	616	
Gain on disposal of property, plant and equipment	<u>388</u>	<u>1,004</u>
		18,688
<b>Expenses:</b>		
Distributions costs	3,500	
Administrative expenses	5,406	
Finance costs	<u>447</u>	<u>(9,353)</u>
Profit before tax		9,335
Income tax expense		<u>(3,081)</u>
Profit for the year		<u>6,254</u>
Attributable to: Holding company		6,171
Non-controlling interest		<u>83</u>
		<u>6,254</u>

<b>Tembea Group</b>		
<b>Consolidated statement of financial position as at 31 March:</b>		
	2019 Sh."000"	2018 Sh."000"
<b>Assets:</b>		
<b>Non-current assets:</b>		
Property, plant and equipment	24,062	19,940
Intangible assets	324	540
	<u>24,386</u>	<u>20,480</u>
<b>Current assets:</b>		
Inventory	1,939	1,771
Trade receivables	9,792	9,085
Cash in hand and bank	3,923	3,679
	<u>15,654</u>	<u>14,535</u>
<b>Total assets</b>	<u>40,040</u>	<u>35,015</u>
<b>Capital and liabilities:</b>		
Ordinary share capital	2,479	2,319
Share premium	5,889	5,569
Other reserves	555	555
Retained earnings	<u>7,040</u>	<u>9,379</u>
	15,963	17,822
Non-controlling interest	<u>483</u>	<u>619</u>
Total equity	<u>16,446</u>	<u>18,441</u>

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

**Additional information:**

1. Intangible assets represent patents held by the company being amortised over their useful life. No new patents were registered in the year.

2. Property, plant and equipment is made up as follows:

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

3. Share capital is made up as follows:

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

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

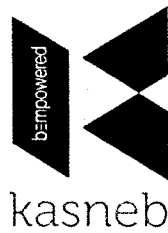
	Sh. "000"
Property, plant and equipment	1,875
Inventory	456
Trade receivables	1,170
Cash at bank and in hand	42
Bank overdraft	(73)
Trade payables	(705)
Medium term bank loans	(967)
Deferred tax	<u>(908)</u>
	<u>890</u>
<b>Consideration:</b>	
Shares allotted	600
Cash	<u>4,400</u>
	<u>5,000</u>

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

**Required:**

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

(20 marks)



CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 30 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) Highlight four limitations of financial reporting in the context of reporting on the social and environmental impacts of corporate activity. (4 marks)
- (b) With regard to International Public Sector Accounting Standard (IPSAS) 4 (The Effects of Changes in Foreign Exchange Rates), explain the accounting treatment of exchange differences arising on translation of both monetary and non-monetary items in the financial statements of a public sector entity. (4 marks)
- (c) On 1 January 2015, G Limited granted each of its 200 employees 500 share options. These share options were to vest if the employees still worked for the entity as at 31 December 2017 and if the share price on that date exceeded Sh.45.

On the grant date, the fair value of each option was Sh.15.

The share price on 31 December 2015 was Sh. 27 and it was considered unlikely that the share price would rise above Sh. 45 by 31 December 2017.

Twenty employees left the company during the year ended 31 December 2015 and a further twenty were expected to leave in each of the two years ended 31 December 2016 and 31 December 2017.

During the years ended 31 December 2016 and 31 December 2017, 15 employees and 25 employees left the company respectively.

**Required:**

Extracts from the financial statements of G Limited for each of the years ended 31 December 2015, 2016 and 2017 to record the above transactions. (6 marks)

- (d) International Financial Reporting Standard (IFRS) 9 (Financial Instruments), sets out the hedge accounting rules which can only be applied if the criteria for the hedging relationship are met.

**Required:**

Citing relevant examples, describe the hedge effectiveness requirements. (6 marks)

**(Total: 20 marks)**

QUESTION TWO

B Limited and H Limited are private liability limited companies operating in the service sector. They have been reporting successive trading losses for several years, principally due to severe competition which has put downward pressure on their revenues.

The directors of the two entities, who are also the main shareholders, have unanimously agreed to wind up the companies' respective businesses and amalgamate them into a new company to be named S Limited with effect from 1 October 2018.

The statements of financial position of the two companies as at 30 September 2018 are as set out below:

	B Limited	H Limited
<b>Assets:</b>		
<b>Non-current assets:</b>	<b>Sh. "000"</b>	<b>Sh. "000"</b>
Property, plant and equipment	16,500	12,000
Intangible assets (copyrights)	<u>8,400</u>	<u>-</u>
	24,900	12,000
Current assets	<u>52,500</u>	<u>30,000</u>
Total assets	<u>77,400</u>	<u>42,000</u>

	Sh. "000"	Sh. "000"
<b>Equity and liabilities:</b>		
<b>Equity:</b>		
Ordinary share capital (Sh.10 par value)	30,000	16,000
7.5% cumulative preference share capital (Sh.10 par value)	10,000	24,000
Share premium	1,600	1,400
Retained profits (losses)	<u>(23,400)</u>	<u>(34,300)</u>
	18,200	7,100
<b>Non-current liabilities:</b>		
10% bonds	20,000	15,000
<b>Current liabilities:</b>		
Trade payables	37,200	18,400
Bank overdraft	<u>2,000</u>	<u>1,500</u>
Total equity and liabilities	<u>77,400</u>	<u>42,000</u>

**Additional information:**

- The authorised share capital of the new company was Sh.120 million comprising 12 million ordinary shares of Sh.10 par value.
- Preference dividends in B Limited were three years in arrears while in H Limited, preference dividends had not been paid for two years including the current year to 30 September 2018. Only 20% of the arrears of preference dividends were settled by issue of ordinary shares of Sh.10 each in S Limited.
- S Limited issued 3.4 million ordinary shares of Sh.10 each credited at Sh.5 each in favour of the preference shareholders in both companies. The ordinary shares were allotted on the basis of the preference shares held in the old companies. The preference shareholders committed to immediately pay the balance on the shares issued.
- The bondholders in both companies were settled immediately by the new company issuing ordinary shares of Sh.10 each to satisfy the nominal value of the bonds.
- The new company also issued 4.6 million ordinary shares of Sh.10 each credited at Sh.2.50 each in favour of the ordinary shareholders in the old companies. The ordinary shares were allotted on the basis of the ordinary shares held in the old companies. The ordinary shareholders were to pay the balance on their shares immediately.
- The current liabilities of the old companies were transferred to the new company at their book values.
- The copyrights in B Limited expired upon amalgamation of the old companies and were therefore to be written off.
- The tangible assets were taken over by S Limited at their fair values as follows:

	B Limited Sh. "000"	H Limited Sh. "000"
Property, plant and equipment	12,500	9,500
Current assets	58,000	38,600

- Liquidation expenses of B Limited and H Limited amounting to Sh.8 million and Sh.5 million respectively were paid for by S Limited and treated as preliminary expenses.
- Assume that all the above transactions were completed by the close of business on 30 September 2018.

**Required:**

- The following ledger accounts, in columnar form, to close off the books of B Limited and H Limited:
    - Realisation account. (4 marks)
    - Preference shareholders sundry members account. (4 marks)
    - Ordinary shareholders sundry members account. (4 marks)
  - Journal entries in the books of S Limited to record the transfer of assets and liabilities (Ignore narrations). (4 marks)
  - Opening statement of financial position of S Limited as at 1 October 2018. (4 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- In the context of the IFRS for Small and Medium-sized Entities (SMEs), identify any four areas where the SMEs standard differs from the IFRSs and IASs adopted by public limited entities. (4 marks)



(b) Below are the statements of financial position of Acacia Ltd., Baobab Ltd. and Cider Ltd. as at 30 June 2018.

	Acacia Ltd. Sh. "million"	Baobab Ltd. Sh. "million"	Cider Ltd. Sh. "million"
<b>Assets:</b>			
<b>Non-current assets:</b>			
Property, plant and equipment	6,000	5,150	2,775
Investments	<u>3,050</u>	<u>200</u>	<u>-</u>
	<u>9,050</u>	<u>5,350</u>	<u>2,775</u>
<b>Current assets:</b>			
Inventories	1,520	645	600
Accounts receivable	735	300	315
Current account - Cider Ltd.	-	105	-
Cash and bank balance	<u>178</u>	<u>450</u>	<u>375</u>
	<u>2,433</u>	<u>1,500</u>	<u>1,290</u>
Total assets	<u>11,483</u>	<u>6,850</u>	<u>4,065</u>
<b>Equity and liabilities:</b>			
<b>Equity:</b>			
Ordinary shares of Sh.1 each	7,550	3,000	1,500
Share premium	67	200	168
Retained profit	<u>1,200</u>	<u>1,650</u>	<u>987</u>
	<u>8,817</u>	<u>4,850</u>	<u>2,655</u>
<b>Non-current liabilities:</b>			
8% debentures	<u>975</u>	<u>1,020</u>	<u>900</u>
<b>Current liabilities:</b>			
Accounts payable	1,050	690	420
Current tax	500	200	-
Dividend payable	141	90	-
Current account - Baobab Ltd.	<u>-</u>	<u>-</u>	<u>90</u>
	<u>1,691</u>	<u>980</u>	<u>510</u>
	<u>11,483</u>	<u>6,850</u>	<u>4,065</u>

**Additional information:**

- Acacia Ltd. acquired 40% of the ordinary shares of Baobab Ltd. on 1 July 2016 at a cost of Sh.1,500 million when the retained profit and share premium of Baobab Ltd. were Sh.810 million and Sh.200 million respectively.  
On 1 January 2018, Acacia Ltd. acquired another 20% of the ordinary shares of Baobab Ltd. for a cash consideration of Sh.1,050 million. On that date, the fair value of the initial 40% ordinary shares of Baobab Ltd. was Sh.1,800 million.
- On 1 January 2018, the carrying amount of the net assets of Baobab Ltd. reflected their fair value with the exception of an item of plant. The market value of the item of plant had decreased and the valuation report indicated a reduction of Sh.150 million. The plant had a remaining useful life of three years as at that date. Baobab Ltd. had not adjusted its books to reflect the new value.
- Acacia Ltd. acquired 60% of the ordinary shares of Cider Ltd. on 1 July 2017 when the retained profit and share premium of Cider Ltd. were Sh.432 million and Sh.168 million respectively. The cost of this transaction was to be discharged by an issue of 600 million ordinary shares of Acacia Ltd. The fair value of the ordinary shares of Acacia Ltd. on 1 July 2017 was Sh.2.5 per share while that of Cider Ltd. was Sh.3.5 per share. This share exchange has not yet been recorded by Acacia Ltd. On 1 July 2017, the carrying amount of the identifiable net assets of Cider Ltd. reflected their fair values.
- A quarter of the inventory of Cider Ltd. was purchased from Baobab Ltd. on 1 June 2018. The inventory had been invoiced at a mark-up of 25%.
- On 1 June 2018, Acacia Ltd. disposed of a property to Baobab Ltd. at Sh.200 million above its carrying amount. The remaining useful life of this property was 10 years.
- At the end of June 2018, Cider Ltd. had declared a final dividend of 3%. These dividends had not been provided for.
- Acacia Ltd. has not yet recorded its share of the ordinary dividend from Baobab Ltd.
- The difference in the current accounts is due to cash in transit.
- Profits and losses of Baobab Ltd. were deemed to accrue evenly from 1 July 2016 until 30 June 2018.
- Acacia Ltd. retained all its investments at cost.
- The depreciation policy of the group is to depreciate all its property, plant and equipment on a straight line basis making a full year's charge in the year of purchase.
- The group values the non-controlling interest at their proportionate share of the fair value of the net assets of the subsidiaries as at the acquisition date.

**Required:**

Consolidated statement of financial position of the Acacia group as at 30 June 2018.

(16 marks)

(Total: 20 marks)

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**QUESTION FOUR**

The following draft consolidated financial statements relate to the Bakoki Ltd. group:

**Consolidated statement of income for the year ended 31 July 2018:**

	Sh. "million"	Sh. "million"
Revenue		5,845
Cost of sales		<u>(2,160)</u>
Gross profit		3,685
Distribution costs	510	
Administrative expenses	<u>230</u>	<u>(740)</u>
		2,945
Income from interests in associated company		<u>990</u>
Operating profit		3,935
Profit on disposal of tangible assets		300
Income from investments		80
Interest payable		<u>(300)</u>
Profit before tax		4,015
Income tax		<u>(1,345)</u>
Profit after tax		2,670
Non-controlling interest (equity)		<u>(200)</u>
Profit attributable to members of group		2,470
Dividend paid		<u>(800)</u>
Retained profit for the year		<u><u>1,670</u></u>

**Consolidated statement of financial position as at 31 July:**

	2018 Sh. "million"	2017 Sh. "million"
<b>Assets:</b>		
<b>Non-current assets:</b>		
Tangible assets	7,750	5,000
Intangible assets	200	-
Investment in associated company	2,200	2,000
Other investments	<u>820</u>	<u>820</u>
	<u>10,970</u>	<u>7,820</u>
<b>Current assets:</b>		
Inventories	3,930	2,000
Trade receivables	3,700	2,550
Cash and bank balances	<u>9,030</u>	<u>3,640</u>
	<u>16,660</u>	<u>8,190</u>
Total assets	<u>27,630</u>	<u>16,010</u>
<b>Equity and liabilities:</b>		
<b>Equity:</b>		
Share capital	7,880	4,000
Share premium	5,766	4,190
Retained earnings	<u>6,270</u>	<u>4,600</u>
	19,916	12,790
Non-controlling interest	<u>230</u>	<u>-</u>
	<u>20,146</u>	<u>12,790</u>
Non-current liabilities	4,400	1,366
Current liabilities	<u>3,084</u>	<u>1,854</u>
Total equity and liabilities	<u>27,630</u>	<u>16,010</u>

**Additional information:**

- Bakoki Ltd. has two wholly owned subsidiaries. In addition, it acquired a 75% interest in Nyange Ltd. on 1 August 2017. It also holds a 40% interest in Birika Ltd. which it acquired several years ago. Goodwill has not become impaired.
- The following are the fair values of Nyange Ltd. at the date of acquisition of its shares:

**Nyange Ltd.****Statement of financial position as at 1 August 2017**

	Sh. "million"	Sh. "million"
Plant and machinery		330
<b>Current assets:</b>		
Inventories	64	
Trade receivables	56	
Cash and bank balance	<u>224</u>	344
Current liabilities (including corporation tax of Sh.34 million)		<u>(170)</u>
		<u>504</u>

	Sh. "million"	Sh. "million"
Share capital		100
Retained earnings		<u>404</u>
		<u>504</u>

3. The consideration for the purchase of the shares of Nyange Ltd. comprised 44 million ordinary shares of Sh.10 of Bakoki Ltd. at a value of Sh.550 million and a further payment of Sh.28 million being made in cash.

4. The tax charge in the consolidated income statement is made up of the following items:

	Sh. "million"
Corporation tax	782
Deferred tax	208
Tax attributable to associated company	<u>355</u>
	<u>1,345</u>

5. The tangible non-current assets of Bakoki Ltd. group comprised the following:

Cost or valuation:	Building Sh. "million"	Plant and Machinery Sh. "million"	Total Sh. "million"
As at 1 August 2017	5,100	2,800	7,900
Additions	-	4,200	4,200
Disposals	<u>-</u>	<u>(1,000)</u>	<u>(1,000)</u>
	<u>5,100</u>	<u>6,000</u>	<u>11,100</u>
<b>Depreciation:</b>			
As at 1 August 2017	700	2,200	2,900
Charge for the year	250	400	650
Disposal	<u>-</u>	<u>(200)</u>	<u>(200)</u>
	<u>950</u>	<u>2,400</u>	<u>3,350</u>
Carrying amount as at 31 July 2018	<u>4,150</u>	<u>3,600</u>	<u>7,750</u>

6. Included in the additions to plant and machinery are items totalling Sh.1,700 million acquired under finance leases. The plant and machinery disposed of during the year resulted in a profit of Sh.300 million. All lease rentals were paid on their due dates.

7. Non-current liabilities comprise the following:

	2018 Sh. "million"	2017 Sh. "million"
Obligations under finance leases	1,417	1,340
6% debentures	2,923	-
Deferred tax	<u>60</u>	<u>26</u>
	<u>4,400</u>	<u>1,366</u>

8. There had been an issue of debentures on 1 August 2017. The par value was Sh.3,000 million but they were issued at a discount of Sh.100 million. The effective rate of interest was 7%.

9. Current liabilities comprised the following items:

	2018 Sh. "million"	2017 Sh. "million"
Trade payables	1,600	960
Obligations under finance leases	480	400
Corporation tax	924	434
Accrued interest	<u>80</u>	<u>60</u>
	<u>3,084</u>	<u>1,854</u>

**Required:**

Consolidated statement of cash flows for the Bakoki Ltd. group for the year ended 31 July 2018, in accordance with the requirements of International Accounting Standard (IAS) 7 "Statement of Cash Flows".

(Total: 20 marks)

**QUESTION FIVE**

- (a) Citing four reasons, explain the usefulness of related party disclosures when analysing the financial position and financial performance of a business organisation. (4 marks)
- (b) Discuss the significance of the earnings per share (EPS) figure in the analysis of the performance of companies. (4 marks)
- (c) IAS 33 (Earnings Per Share) sets out the requirements for calculating and disclosing the basic earnings per share figure for quoted entities.

The following figures appeared in the consolidated income statement and other comprehensive income of Uwezo Ltd. for the year ended 31 July 2018 together with comparatives for the year ended 31 July 2017:

	2018 Sh. "million"	2017 Sh. "million"
Profit before tax	400	300
Income tax	<u>(75)</u>	<u>(60)</u>
Profit after tax	325	240
Other comprehensive income (Revaluation gain on land)	<u>30</u>	<u>10</u>
Total comprehensive income	<u>355</u>	<u>250</u>
Profit after tax for the year attributable to:		
Owners of the group	280	210
Non-controlling interest	<u>45</u>	<u>30</u>
	<u>325</u>	<u>240</u>
Total comprehensive income for the year attributable to:		
Owners of the group	310	220
Non-controlling interest	<u>45</u>	<u>30</u>
	<u>355</u>	<u>250</u>

The statement of financial position extract as at 31 July 2018 together with comparatives for the year ended 31 July 2017 were as follows:

	2018 Sh. "million"	2017 Sh. "million"
Equity share capital (Sh.0.5 each)	460	200
4% preference share capital	100	100
Share premium	215	60
Other equity reserves	90	60
Non-controlling interest	85	40
Retained earnings	<u>688</u>	<u>570</u>
Total equity	<u>1,638</u>	<u>1,030</u>

During the year ended 31 July 2018, the following changes took place in relation to the issued share capital of Uwezo Ltd.:

1. 100 million equity shares were issued in relation to the acquisition of another business. These shares were issued at full market price on 1 November 2017.
2. 150 million ordinary shares were issued for cash to existing shareholders on 1 February 2018. The issue price was Sh.1.5 per share which represents a discount of 25% on the traded price of Sh.2.0 per share immediately before the issue.
3. On 30 June 2018, a bonus issue was completed by capitalising Sh.135 million of retained earnings.
4. On 31 July 2018, the preference dividend for the year and an equity dividend of Sh.23 million were paid.

**Required:**

- (i) The basic earnings per share (EPS) for the years ended 31 July 2017 and 31 July 2018. (10 marks)
  - (ii) The comparative EPS for 2017 to be reported in the 2018 financial statements. The EPS figure reported in 2017 was Sh.0.525. (2 marks)
- (Total: 20 marks)**



CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

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FRIDAY: 25 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) The Global Reporting Initiative (GRI) has a mission to develop global sustainability reporting guidelines for voluntary use by organisations reporting on the three linked elements of sustainability namely; the economic, environmental and social dimensions of their activities, products and services:

**Required:**

Describe four social indicators that might be reported under the social dimension. (8 marks)

- (b) With regard to IPSAS 22 (Disclosure of Financial Information about the general Government Sector), highlight four characteristics of a government business enterprise (GBE). (4 marks)

- (c) The IASB framework for the preparation and presentation of financial statements sets out the concepts that underlie the development of accounting standards.

**Required:**

Discuss two challenges that might be encountered in the practical application of the above framework. (4 marks)

- (d) Under certain circumstances, non compliance with the detailed provisions of an accounting standard might be justified.

**Required:**

Highlight four disclosures that an entity that has elected not to comply with an accounting standard must make in order to explain the circumstances of the non compliance. (4 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) Explain the following terms as used in IAS 33 (Earnings Per Share):

(i) Contingently issuable ordinary shares. (2 marks)

(ii) Dilution. (2 marks)

- (b) The following statement of financial position relates to the affairs of Fanakawa Ltd. as at 31 December 2017:

	Sh. "000"	Sh. "000"
<b>Assets:</b>		
<b>Non-current assets:</b>		
Land and buildings		3,160
Plant and machinery		4,040
<b>Intangible assets:</b>		
Goodwill		1,300
Development expenditure		750
<b>Current assets:</b>		
Inventories	1,900	
Receivables	<u>1,700</u>	<u>3,600</u>
Total assets		<u>12,850</u>
<b>Equity and liabilities:</b>		
<b>Equity:</b>		
Ordinary share capital (Sh.10 par value)		6,000
Share premium		2,000
Accumulated losses		<u>(2,070)</u>
Shareholders' funds		5,930

	Sh."000"	Sh."000"
<b>Current liabilities:</b>		
Trade payables	1,820	
Bank overdraft	1,100	
Bank loan (secured on land and buildings)	<u>4,000</u>	<u>6,920</u>
Total equity and liabilities		<u>12,850</u>

**Additional information:**

Fanakawa Ltd. has been making losses in recent years, but recent board changes and the development of a new product line are believed to have significantly improved the company's future prospects. The following scheme of financial reorganisation has been prepared for consideration by the shareholders and creditors:

- The existing ordinary shares are to be written down to Sh.4 per share and then consolidated into shares of Sh.10 par.
- Existing shareholders are to subscribe to a rights issue of three new shares for every one share held after making the changes in (1) above. The shares are to be issued at Sh.11 each.
- The company's major supplier has agreed to convert an amount of Sh.1,000,000 owed to him into fully paid ordinary shares issued at par.
- The bank requires immediate payment of the overdraft but has agreed to convert the loan currently payable on demand, into a debenture carrying an interest of 10% per annum payable in full in the next 5 years.
- The balances in the accumulated losses and goodwill accounts are to be written off.
- Development expenditure is to be written off.
- The remaining assets are to be restated to their fair values as follows:

	Sh. "000"
Land and buildings	3,320
Plant and machinery	1,000
Inventories	1,500
Receivables	1,700

- The amount in the share premium account is to be utilised in the capital reduction scheme.

**Required:**

- Journal entries to record the above transactions. (6 marks)
- Capital reduction account. (4 marks)
- Statement of financial position after effecting the scheme of capital reduction. (6 marks)

**(Total: 20 marks)**

**QUESTION THREE**

The following financial statements relate to Radi Ltd. (the investor entity) and two investee companies which also operate in the same industry as the investor entity:

**Statement of comprehensive income for the year ended 30 April 2018**

	Radi Ltd. Sh."000"	Mvua Ltd. Sh."000"	Upepo Ltd. Sh."000"
Revenue	92,500	48,000	30,000
Cost of sales	<u>(70,500)</u>	<u>(36,000)</u>	<u>(18,000)</u>
Gross profit	22,000	12,000	12,000
Distribution expenses	<u>(2,500)</u>	<u>(1,200)</u>	<u>(1,000)</u>
Administrative expenses	<u>(5,500)</u>	<u>(2,400)</u>	<u>(2,000)</u>
Finance cost	<u>(100)</u>	-	-
Profit before tax	13,900	8,400	9,000
Income tax	<u>(3,900)</u>	<u>(1,600)</u>	<u>(2,200)</u>
Profit for the year	<u>10,000</u>	<u>6,800</u>	<u>6,800</u>
Other comprehensive income:			
Gain on revaluation of land	<u>500</u>	-	-
Total comprehensive income	<u>10,500</u>	<u>6,800</u>	<u>6,800</u>

**Statement of financial position as at 30 April 2018**

	Radi Ltd. Sh."000"	Mvua Ltd. Sh."000"	Upepo Ltd. Sh."000"
<b>Assets:</b>			
<b>Non-current assets:</b>			
Property, plant and equipment	18,300	18,900	15,000
Investments	<u>12,600</u>	<u>1,200</u>	<u>350</u>
	<u>30,900</u>	<u>20,100</u>	<u>15,350</u>

	Sh."000"	Sh."000"	Sh."000"
<b>Current assets:</b>			
Inventory	5,200	1,000	1,400
Trade and other receivables	4,580	800	900
Financial assets at fair value	1,200	350	500
Cash and bank	1,520	250	200
	<u>12,500</u>	<u>2,400</u>	<u>3,000</u>
Total assets	43,400	22,500	18,350
<b>Equity and liabilities:</b>			
<b>Equity:</b>			
Ordinary share capital (Sh.1 par value)	15,000	5,000	6,000
Revaluation reserve (property, plant and equipment)	2,000	-	-
Other equity reserve	500	-	-
Retained earnings	12,900	9,500	5,000
	<u>30,400</u>	<u>14,500</u>	<u>11,000</u>
<b>Non-current liabilities:</b>			
6% loan notes	3,000	-	-
Deferred tax	1,600	1,200	350
	<u>4,600</u>	<u>1,200</u>	<u>350</u>
<b>Current liabilities:</b>			
Trade and other payables	5,600	5,600	5,000
Current tax	2,800	1,200	2,000
	<u>8,400</u>	<u>6,800</u>	<u>7,000</u>
Total equity and liabilities	43,400	22,500	18,350

**Additional information:**

- On 1 January 2018, Radi Ltd. acquired 80% of the equity shares of Mvua Ltd. The consideration consisted of two elements; a share exchange of three shares in Radi Ltd. for every five shares acquired in Mvua Ltd. and the issue of a Sh.100, 6%, loan note for every 500 shares acquired in Mvua Ltd. The share issue has not yet been recorded by Radi Ltd., but the issue of the loan note has been recorded. At the date of acquisition, shares in Radi Ltd. had a market value of Sh.5 each and the shares of Mvua Ltd. had a stock market price of Sh.3.50 each.

Radi Ltd. had earlier acquired 2.4 million shares of Upepo Ltd. on the securities exchange at a price of Sh.1.5 per share on 1 November 2017.

- As at the date of acquisition of the shares in Mvua Ltd., the fair value of Mvua Ltd.'s assets was equal to their carrying amount with the exception of its property which had a fair value of Sh.1.2 million below its carrying amount. This property had a remaining useful life of 8 years.
- The group policy is to revalue all properties to current value at each year end. On 30 April 2018, the value of Mvua Ltd.'s property was unchanged from its value at acquisition, but the land element of Radi Ltd.'s property had increased in value by Sh.500,000 as shown in other comprehensive income.
- Sales from Mvua Ltd. to Radi Ltd. in the post-acquisition period were Sh.4,000,000. Mvua Ltd. made a mark-up of 25% on these sales. As at 30 April 2018, Radi Ltd. had Sh.2,000,000 (at cost to Radi Ltd.) of inventory that had been supplied in the post-acquisition period by Mvua Ltd.
- In April 2018, Radi Ltd. sold goods to Upepo Ltd. for Sh.2,000,000, realising a profit mark-up of 25%. The entire consignment remained unsold as at 30 April 2018 and was included in the inventory of Upepo Ltd.
- Radi Ltd.'s investments include some available for sale investments that had increased in value by Sh.300,000 during the year. The other equity reserve relates to these investments and is based on their value as at 30 April 2017. There were no acquisitions or disposals of any of these investments during the year ended 30 April 2018.
- The group policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, the price of Mvua Ltd.'s share as at that date can be determined to be representative of the fair value of the shares held by the non-controlling interest.
- It was determined at the year end that 10% of the goodwill relating to the acquisition of Mvua Ltd. was impaired.
- Radi Ltd. owed Mvua Ltd. Sh.100,000 as at the year end with regard to the transaction in Note (4) above. The books of Radi Ltd. however showed that it owed Mvua Ltd. only Sh.80,000. Radi Ltd. had sent a cheque to Mvua Ltd. on 27 April 2018 which had not been received by Mvua Ltd. until 4 May 2018.

**Required:**

- Consolidated statement of comprehensive income for the year ended 30 April 2018. (10 marks)
  - Consolidated statement of financial position as at 30 April 2018. (10 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- E Ltd. issued a bond for Sh.200 million on 1 January 2018. Interest on the bond is payable in arrears on 31 December each year at the rate of 12% per annum. The bond will be held to maturity and redeemed on 31 December 2020 for Sh.258.24 million. The effective rate of interest is 20% per annum. The bond has not been designated as at fair value through profit or loss (FVTPL).

**Required:**

- (i) Charge to the income statement for each of the two years ending 31 December 2018 and 31 December 2019. (4 marks)
- (ii) Extracts from the statement of financial position as at 31 December 2018 and 31 December 2019. (2 marks)
- (b) Ufanisi Ltd. operates a defined benefit plan for its employees. The plan is contributory and the details of the benefits plan for the year ended 30 November 2017 were as follows:

	Sh. "million"
Plan assets as at 1 December 2016	30,540
Plan assets as at 30 November 2017	33,384
Current service cost	420
Post service cost	270
Employees' contributions	1,260
Employer's contributions	360
Benefits paid	1,080
Foreign exchange losses on plan assets	600
Dividend income on plan assets invested in shares	414
Interest income on plan assets invested in bonds	240
Rental income from benefit plan properties	166.5
Foreign tax on income from foreign investments	90
Net profit on disposal of plan investments	300
Administrative expenses of benefit plan management	210
General expenses of benefit plan management	60

**Additional information:**

- The present value of plan obligations as at 1 December 2016 stood at Sh.33,600 million while as at 30 November 2017, it was Sh.35,241 million.
- The interest rate on high quality corporate debt (constant during the year) was 5% per annum.
- Benefits paid, employer's contributions and employees' contributions were all evenly spread over the year.
- The past service cost arose as a result of improvement in benefits offered to all plan members effective from 1 November 2016. In order to receive the benefit, plan members must have remained in employment until at least 30 November 2017. The figures provided above are the total expected costs as calculated by the actuary.

**Required:**

- (i) Statement of changes in the fair value of plan assets in accordance with IAS 19 (Employee Benefits) for the year ended 30 November 2017. (4 marks)
- (ii) Statement of changes in the present value of plan obligations in accordance with IAS 19 for the year ended 30 November 2017. (4 marks)
- (iii) Statement of changes in net assets available for benefits for the plan itself as required by IAS 26 (Accounting and Reporting by Retirement Benefit Plans). (6 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

G Ltd. is a company that is quoted on the securities exchange. The following trial balance was extracted from the books of the company as at 31 March 2018:

	Sh. "000"	Sh. "000"
Revenue		18,960
6% convertible bonds		3,000
Cost of sales	5,670	
Property, plant and equipment	19,420	
Intangible assets	1,750	
Administrative expenses	2,830	
Selling and distribution cost	1,890	
Provision for damages		1,200
Finance cost	1,560	
Inventories	4,730	
Trade and other receivables	1,270	
Ordinary share capital		5,800
Trade and other payables		920
Retained earnings		5,410
Instalment tax paid	740	



	Sh. "000"	Sh. "000"
Deferred tax		270
Share premium		1,400
Revaluation reserve (property, plant and equipment)		1,500
Cash in hand	380	
Financial assets at fair value	1,250	
Investment income		120
Accumulated depreciation (property, plant and equipment)		<u>2,910</u>
	<u>41,490</u>	<u>41,490</u>

**Additional information:**

- G Ltd. is also a sales agent for another company, P Ltd. and is entitled to a sales commission of 10% on the sales made on behalf of P Ltd. The net proceeds obtained from the sale (after deducting the commission) are remitted to P Ltd. During the financial year ended 31 March 2018, G Ltd. sold goods worth Sh.2,400,000 on behalf of P Ltd. This amount was included in the sales revenue disclosed in the trial balance. G Ltd. had not remitted the net sales proceeds to P Ltd. as at 31 March 2018.
- During the year ended 31 March 2018, G Ltd. incurred Sh.1,750,000 relating to research and development expenditure on a new product. All of this expenditure was capitalised as an intangible asset. The Sh.1,750,000 expenditure was composed of the following costs:

	Sh. "000"
Background investigation work (1 April 2017 – 31 May 2017)	250
Initial development work (1 June 2017 – 15 July 2017)	428
Second phase development work (16 July 2017 – 30 November 2017)	600
Product launch cost (December 2017)	316
Staff training (February 2018)	<u>156</u>
	<u>1,750</u>

The product was assessed as being commercially viable on 16 July 2017 and product development was completed on 30 November 2017. The product was launched in December 2017 although the first products were not delivered until April 2018.

- On 1 April 2017, G Ltd. issued Sh.3,000,000, 6% convertible bonds at par. Each bond could be redeemed for cash at par or converted into three ordinary shares on 31 March 2020. The interest due on the bonds was paid on 1 April 2018. The equivalent effective interest rate on similar bonds without the conversion right is 9% per annum. The only accounting entries which had been made as at 31 March 2018 were to recognise the Sh.3,000,000 cash proceeds as a non-current liability.
- On 1 January 2018, G Ltd. made a one-off purchase from a supplier in Zebuland. The goods were invoiced in the local currency of Zebuland which is the Zebu (Zb). The purchase was for Sh.2,200,000 and a 120-day credit period was given by the supplier. The purchase was recognised in purchases and payables using the 1 January 2018 spot exchange rate. No other accounting entries have been made. The cash was paid to the supplier on 1 May 2018. The relevant spot exchange rates were as follows:
 

1 January 2018	-	1 Ksh	=	10 Zb
31 March 2018	-	1 Ksh	=	11 Zb
1 May 2018	-	1 Ksh	=	12 Zb
- Depreciation on property, plant and equipment for the year ended 31 March 2018 has not yet been charged. All depreciation is provided on a straight line basis. Buildings were assessed as having a 40-year useful life and plant and machinery a 15-year useful life with a scrap value of Sh.150,000.

The cost of property, plant and equipment as at 1 April 2017 included:

	Sh.
Land	13,420,000
Building	3,600,000
Plant and machinery	2,400,000

Depreciation on plant and machinery is classified as cost of sales while depreciation on building is classified as administrative expenses.

- Selling and distribution expenses included a provision for damages payable to a customer whose order had not been delivered on time. A provision for damages amounting to Sh.1,200,000 had been made. This provision is to be reversed.
- The current year's tax is estimated at Sh.980,000. The net taxable temporary differences amount to Sh.840,000.
- The applicable tax rate is 30%.

**Required:**

The following statements in a form suitable for publication:

- Statement of comprehensive income for the year ended 31 March 2018. (10 marks)
- Statement of changes in equity for the year ended 31 March 2018. (2 marks)
- Statement of financial position as at 31 March 2018. (8 marks)

**(Total: 20 marks)**



CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 1 December 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) Explain three benefits of integrated reporting to both an organisation and the users of financial statements. (6 marks)
- (b) The following statements of comprehensive income relate to W Ltd. and its investee companies S Ltd. and F Ltd. for the year ended 31 March 2017:

Statements of comprehensive income:

	W Ltd. Sh."million"	S Ltd. Sh."million"	F Ltd. Sh."million"
Revenue	976	420	63
Cost of sales	(687)	(228)	(26.2)
Gross profit	289	192	36.8
Other income	6.1	-	-
Dividend received	8.1	-	-
Operating expenses	(68)	(54)	(13.4)
Finance cost	(12)	(18)	(6.2)
Profit before tax	223.2	120	17.2
Income tax expense	(45)	(30)	(3.2)
Profit after tax for the year	178.2	90	14
Other comprehensive income:			
Gain on revaluation of property	15	12	2
Total comprehensive income for the year	193.2	102	16
Retained earnings (1 April 2016)	2,350	625	145
Equity share capital (1 April 2016)	1,000	775	10

Additional information:

- W Ltd. bought 60% holding in the equity shares of S Ltd. on 1 April 2016. The purchase consideration was agreed at Sh.900 million of which Sh.600 million was paid in cash. The balance was satisfied by immediate issue of a 5% bond at par. S Ltd.'s net assets had a fair value of Sh.1,400 million as at 1 April 2016 represented by equity share capital of Sh.775 million and retained earnings of Sh.625 million. It was decided to apply the proportion of net assets method to calculate goodwill on acquisition. No impairment loss on goodwill arose during the year ended 31 March 2017.
- W Ltd. sold its entire 60% equity holding in S Ltd. on 31 March 2017 for Sh.1,150 million in cash. No entry had been made to reflect this transaction.
- W Ltd. owned 90% of the equity shares of F Ltd. since incorporation. No goodwill arose on this acquisition. There were no retained earnings in existence as at the acquisition date.
- During the year ended 31 March 2017, W Ltd. sold goods to F Ltd. for Sh.15 million. These goods were sold by W Ltd. at a mark-up of 50% on cost. Three fifth (3/5) of these goods remained in the inventory of F Ltd. as at 31 March 2017. An amount of Sh.4.3 million remained outstanding to W Ltd. in respect of these goods as at 31 March 2017.
- On 1 March 2017, F Ltd. declared an interim dividend of Sh.9 million. W Ltd. has recorded its share of this dividend as income. No other dividends were declared by the group companies during the year ended 31 March 2017.
- All expenses and gains are assumed to accrue evenly throughout the year. No new equity capital was issued by any group company during the year ended 31 March 2017.
- Interest on the 5% bond was payable in arrears. No payment had been made or provided for.

**Required:**

- (i) The gain (or loss) on disposal of the shares in S Ltd. on 31 March 2017. (4 marks)
- (ii) Consolidated statement of comprehensive income for the year ended 31 March 2017. (10 marks)

**(Total: 20 marks)****QUESTION TWO**

- (a) With reference to International Public Sector Accounting Standard (IPSAS) 21 "Impairment of Non-Cash-Generating Assets", explain three matters in respect of which an entity should disclose each material impairment loss recognised or reversed during the reporting period. (6 marks)
- (b) On 1 January 2014, R Ltd. promised to pay its 200 employees a bonus in cash that would be based on how the company's share performed on the securities exchange. The bonus was to be paid on 31 December 2016 as long as the market price of the company's share was Sh.55 and above and the employee was still working for the company. As at 1 January 2014, the market price of the share was Sh.50 and the par value of one share was Sh.10. The bonus was to be the equivalent of 100 shares.

The following information in relation to the three years was availed:

Year ended	Number of employees leaving	Market price of a share (Sh.)
31 December 2014	10	55
31 December 2015	15	58
31 December 2016	15	60

All the employees who were in employment as at 31 December 2016 were paid the bonus.

**Required:**

Show how the bonus would be accounted for and reported over the three-year period ended 31 December 2016.

(6 marks)

- (c) The following information was extracted from the books of Comfort Retirement Benefit Scheme for the years ended 31 October 2016 and 31 October 2017:

	2016	2017
Discount rate on 1 November	10%	8%
Expected rate of return on plan assets – 1 November	12%	10%
Average remaining service life (years)	10	10
	2016	2017
	Sh. "million"	Sh. "million"
Fair value of plan assets – 1 November	96	110
Present value of plan obligations – 1 November	100	125
Current service cost	8	10
Benefits paid	15	12
Contributions to the scheme	9	11
Past service cost	4	-

**Additional information:**

- As at 1 November 2015, the present value of plan obligations and the fair value of plan assets were both Sh.100 million.
- Assume all transactions occurred at the year end.

**Required:**

For each of the years ended 31 October 2016 and 31 October 2017, determine:

- (i) The actuarial gains or losses. (2 marks)
- (ii) The net pension cost to be charged in the income statement for each of the two years. (4 marks)
- (iii) Balances to be reflected in the statement of financial position as at the end of each year. (2 marks)

**(Total: 20 marks)****QUESTION THREE**

- (a) Citing three reasons, explain the rationale behind the inclusion of an environmental report in a reporting entity's annual report. (6 marks)
- (b) The following are the group statement of comprehensive income and the group statement of financial position of Maneno Group of Companies for the financial years ended 31 October 2016 and 31 October 2017:

**Maneno Group**  
**Statement of comprehensive income for the year ended 31 October 2017**

	Sh. "million"	Sh. "million"
Revenue		3,075
Cost of sales		(1,470)
		1,605
Gain on sale of subsidiary		120
Share of profit after tax in associate		<u>144</u>
		1,869
<b>Expenses:</b>		
Distribution costs	240	
Administrative expenses	480	
Finance cost	<u>450</u>	<u>1,170</u>
Profit before tax		699
Income tax expense		(144)
Profit after tax for the year		555
Gain on revaluation of land		<u>60</u>
Total comprehensive income for the year		<u>615</u>
Attributable to: Parent	540	
Non-controlling interest	<u>75</u>	<u>615</u>

**Maneno Group**  
**Statement of financial position as at 31 October:**

	2017		2016	
	Sh. "million"	Sh. "million"	Sh. "million"	Sh. "million"
<b>Assets:</b>				
<b>Non-current assets:</b>				
Property, plant and equipment		18,000		13,500
Goodwill		255		390
Investment in associate		<u>510</u>		<u>420</u>
		18,765		14,310
<b>Current assets:</b>				
Inventory	3,900		3,090	
Trade receivables	3,120		3,120	
Financial assets at fair value	135		30	
Cash and bank balances	<u>510</u>	<u>7,665</u>	<u>390</u>	<u>6,630</u>
<b>Total assets</b>		<u>26,430</u>		<u>20,940</u>
<b>Equity and liabilities:</b>				
Ordinary share capital		6,000		4,500
Share premium		900		-
Revaluation reserve		150		-
Retained profit		<u>10,200</u>		<u>9,960</u>
Shareholders' funds attributable to parent		17,250		14,460
Shareholders' funds attributable to non-controlling interest		<u>225</u>		<u>525</u>
		17,475		14,985
<b>Non-current liabilities:</b>				
Bank loans	4,200		3,000	
Obligations under finance lease	630		135	
Deferred tax	<u>1,020</u>	5,850	<u>915</u>	4,050
<b>Current liabilities:</b>				
Trade payables	2,955		1,785	
Accrued interest	21		27	
Current tax	84		63	
Obligations under finance lease	<u>45</u>	<u>3,105</u>	<u>30</u>	<u>1,905</u>
<b>Total equity and liabilities</b>		<u>26,430</u>		<u>20,940</u>

**Additional information:**

- During the year ended 31 October 2017, depreciation of Sh.240 million was charged in relation to property, plant and equipment.
- An item of property with a carrying value of Sh.885 million was disposed of during the year ended 31 October 2017 for Sh.750 million in cash. The loss on disposal is part of the cost of sales.

3. On 1 August 2017, the group disposed of an 80% owned subsidiary for Sh.1,170 million in cash. The subsidiary had the following net assets as at the date of disposal:

	Sh. "million"
Property, plant and equipment	2,025
Inventory	90
Trade receivables	135
Cash and bank balances	105
Trade payables	(540)
Current tax	(15)
Bank loans	<u>(600)</u>
	<u>1,200</u>

- The subsidiary had been acquired on 1 November 2012 for a cash payment of Sh.660 million when its net assets had a fair value of Sh.675 million and the non-controlling interest had a fair value of Sh.150 million.
4. Additional property, plant and equipment was acquired by way of lease amounting to Sh.900 million during the year ended 31 October 2017.
5. Dividends paid by the holding company during the year ended 31 October 2017 amounted to Sh.120 million.
6. Land was revalued upwards by the holding company by Sh.60 million during the year ended 31 October 2017.

**Required:**

The group statement of cash flows in accordance with International Accounting Standard (IAS) 7 "Statement of Cash Flows" for the year ended 31 October 2017.

(14 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) International Financial Reporting Standard (IFRS) 3 "Fair Value Measurement" establishes a fair value hierarchy that categorises into three levels the inputs to the valuation techniques used to measure fair value.

**Required:**

Explain the three levels referred to above.

(6 marks)

- (b) The following information relates to SugarServe Ltd. for the year ended 31 May 2016:

1. The net profit of the company for the period attributable to preference shareholders and ordinary shareholders of the company was Sh.14.6 million.

2. Information on ordinary shares was as follows:

	"million"
• Ordinary shares of Sh.10 each in issue as at 1 June 2015	6
• Ordinary shares issued on 1 September 2015 at full price	1.2

- The average market price of the shares for the year ended 31 May 2016 was Sh.100 and the closing price of the shares as at 31 May 2016 was Sh.110. On 1 January 2016, 300,000 partly paid ordinary shares of Sh.10 each were issued. They were issued at Sh.80 per share with Sh.40 payable on 1 January 2016 and Sh.40 payable on 1 January 2017. Dividend participation was 50% until fully paid.

3. Convertible loan stock of Sh.20 million at an interest rate of 5% per annum was issued at par on 1 April 2015. Half year's interest was payable on 30 September and 31 March each year. Each Sh.1,000 of the loan stock was convertible at the holder's option into 300 ordinary shares at any time. Sh.5 million of the loan stock was converted into ordinary shares on 1 April 2016 when the market price of the shares was Sh.100 per share.
4. Sh.1 million of convertible preference shares of Sh.10 each were issued in the year ended 31 May 2012. Dividends were to be paid half yearly on 30 November and 31 May at the rate of 6% per annum. The preference shares were convertible into ordinary shares at the option of the preference shareholders on the basis of two ordinary shares for each preference share issued. Holders of Sh.600,000 preference shares converted them into ordinary shares on 1 December 2015.
5. Corporate tax rate was 30%.

**Required:**

- (i) Basic earnings per share (EPS) for the year ended 31 May 2016.

(6 marks)

- (ii) Diluted EPS for the year ended 31 May 2016.

(8 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Highlight six examples of unethical behaviour by the management of business entities which professional accountants should report about. (6 marks)
- (b) (i) With reference to International Financial Reporting Standard (IFRS) 8 "Operating Segments", outline four disclosure requirements for a reportable segment. (4 marks)
- (ii) The following information was obtained from the financial records of Super Food Group for the year ended 31 October 2017:

**Consolidated income statement for the year ended 31 October 2017:**

	Sh. "000"
Sale of goods	237,489
Service revenue	17,131
Rental income	<u>1,404</u>
Revenue	256,024
Cost of sales	(163,816)
Gross profit	92,208
Other income	1,585
Selling and distribution costs	(14,775)
Administrative expenses	(64,055)
Other expenses	<u>(1,088)</u>
Operating profit	13,875
Finance revenue	785
Finance cost	(1,627)
Share of associate's profit	<u>83</u>
Profit before tax	13,116
Tax expense	<u>(3,775)</u>
Profit after tax for the year	<u>9,341</u>

**Consolidated statement of financial position as at 31 October 2017:**

	Sh. "000"	Sh. "000"
<b>Assets:</b>		
<b>Non-current assets:</b>		
Property, plant and equipment		33,919
Investment properties		10,803
Intangible assets		6,195
Investment in associate		764
Available for sale investments		10,082
Deferred tax assets		<u>383</u>
		62,146
<b>Current assets:</b>		
Inventories	33,875	
Trade and other receivables	39,873	
Derivative financial instruments	153	
Cash and short-term deposits	<u>22,628</u>	<u>96,529</u>
<b>Total assets</b>		<u>158,675</u>
<b>Equity and liabilities:</b>		
Issued share capital		52,375
Retained earnings		<u>39,190</u>
		91,565
<b>Non-current liabilities:</b>		
Interest bearing loans and borrowings		15,078
Convertible preference shares		2,778
Employee benefit liabilities		7,644
Deferred tax liability		3,103
<b>Current liabilities:</b>		
Trade and other payables	17,841	
Interest bearing loans and borrowings	2,460	
Income tax payable	3,980	
Provisions	599	
Other liabilities	<u>13,627</u>	<u>38,507</u>
<b>Total equity and liabilities</b>		<u>158,675</u>

**Additional information:**

- For management purposes, the business is organised into five operating segments: retail, catering, manufacturing, publishing and others.
- Details of the operating segments are provided below:

(a) Revenues	Total revenue	Inter-segment revenue
	Sh. "000"	Sh. "000"
Retail	129,842	-
Catering	66,853	7,465
Manufacturing	39,495	36,791
Publishing	32,306	-
Others	37,447	5,663

(b) Operating profit	Sh. "000"
Retail	6,887
Catering	4,716
Manufacturing	1,283
Publishing	1,169
Others	3,284

(c) Segment assets and liabilities	Assets	Liabilities
	Sh. "000"	Sh. "000"
Retail	50,152	14,839
Catering	45,145	9,783
Manufacturing	24,620	3,609
Publishing	14,165	4,704
Others	23,829	34,175
Investment in associate	764	

- Inter-segment profit amounted to Sh.4,223,000.

**Required:**

Segment report, as far as the information provided above allows, according to International Financial Reporting Standard (IFRS) 8 "Operating Segments".

(10 marks)

(Total: 20 marks)

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# KASNEB

## CPA PART III SECTION 6

### ADVANCED FINANCIAL REPORTING

FRIDAY: 26 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

The following is the summary of financial statements relating to A Ltd., B Ltd., C Ltd. and D Ltd. for the financial year ended 31 March 2017:

#### Income statements for the year ended 31 March 2017:

	A Ltd. Sh."million"	B Ltd. Sh."million"	C Ltd. Sh."million"	D Ltd. Sh."million"
Revenue	1,200	850	600	800
Cost of sales	(650)	(450)	(320)	(410)
Gross profit	550	400	280	390
Other incomes	50	29.5	-	-
	600	429.5	280	390
Distribution costs	(120)	(70)	(90)	(100)
Administrative expenses	(180)	(80)	(120)	(120)
Finance cost	(20)	(10)	(30)	(20)
Profit before tax	280	269.5	40	150
Income tax expense	(60)	(80)	(12)	(50)
Profit for the period	220	189.5	28	100
Dividends paid	(80)	(60)	(10)	(50)
Retained profit for the year	140	129.5	18	50
Retained profit brought forward	450	300	218	260
Retained profit carried forward	590	429.5	236	310

#### Statement of financial position as at 31 March 2017:

	A Ltd. Sh."million"	B Ltd. Sh."million"	C Ltd. Sh."million"	D Ltd. Sh."million"
<b>Assets:</b>				
<b>Non-current assets:</b>				
Property, plant and equipment	1,400	800	1,200	1,100
Intangible assets	250	180	200	120
Investment in B Ltd.	800			
Investment in C Ltd.		600		
Investment in D Ltd.		400		
Available for sale financial assets	50	30		
	2,500	2,010	1,400	1,220
<b>Current assets:</b>				
Inventory	100	80	90	70
Trade and other receivables	160	140	150	120
Bank and cash balances	40	60	30	50
	300	280	270	240
<b>Total assets</b>	<b>2,800</b>	<b>2,290</b>	<b>1,670</b>	<b>1,460</b>
<b>Capital and liabilities:</b>				
Ordinary share capital (Sh.10 par value)	1,000	500	400	500
Share premium	400	300	250	300
Available for sale reserve	10	5		
Retained profits	590	429.5	236	310
	2,000	1,234.5	886	1,110



	A Ltd. Sh. "million"	B Ltd. Sh. "million"	C Ltd. Sh. "million"	D Ltd. Sh. "million"
<b>Non-current liabilities:</b>				
10% loan stock	200	100	300	200
Deferred tax	<u>40</u>	<u>30</u>	<u>20</u>	<u>30</u>
	<u>240</u>	<u>130</u>	<u>320</u>	<u>230</u>
<b>Current liabilities:</b>				
Trade and other payables	280	425.5	260	100
Bank loans	200	400	150	-
Current tax	<u>80</u>	<u>100</u>	<u>54</u>	<u>20</u>
	<u>560</u>	<u>925.5</u>	<u>464</u>	<u>120</u>
Total capital and liabilities	<u>2,800</u>	<u>2,290</u>	<u>1,670</u>	<u>1,460</u>

**Additional information:**

1. A Ltd. acquired 80% of the share capital in B Ltd. on 1 April 2014 when the retained profits of B Ltd. were Sh.100 million. An item of plant in B Ltd. had a fair value of Sh.20 million above its carrying amount and depreciation is at 20% per annum. There were no other reserves other than the share premium.
2. B Ltd. acquired 75% of the share capital in C Ltd. on 1 April 2015 when the retained profits of C Ltd. were Sh.100 million. Land belonging to C Ltd. had a fair value of Sh.50 million above its carrying amount.
3. B Ltd. also acquired 40% shares of D Ltd. on 1 April 2015 when the retained profits of D Ltd. were Sh.150 million.
4. The group uses the partial goodwill method and even though no impairment was reported in previous years, half of the goodwill has been reported impaired in the current year for B Ltd. and C Ltd. The goodwill of D Ltd. was not impaired.
5. Intercompany sales were as follows during the year:

Seller	Buyer	Selling price Sh. "million"	Margin %	Balance in stock
C Ltd.	B Ltd.	200	50	50%
B Ltd.	A Ltd.	250	40	25%
B Ltd.	D Ltd.	100	40	-

6. Inter-company balances were as follows:

	Sh. "million"
Due from B Ltd. to C Ltd.	40
Due from A Ltd. to B Ltd.	50
Due from D Ltd. to B Ltd.	20

**Required:**

- (a) Consolidated income statement for the year ended 31 March 2017. (10 marks)
  - (b) Consolidated statement of financial position as at 31 March 2017. (10 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) Explain the accounting treatment of embedded derivatives under IFRS 9 (Financial Instruments). (4 marks)
- (b) Distinguish between a "fair value hedge" and a "cash flow hedge" citing the accounting treatment of each. (6 marks)
- (c) On 1 January 2014, Comair Ltd. issued 500 share options to each of its 1,000 employees eligible for the employee share ownership scheme.

The fair value of each option at the date of grant was Sh.30. The options had a vesting period of three years, and any employee who resigned before 31 December 2016 was not entitled to any shares.

As at 1 January 2014, the management estimated that 5% of the employees would exit during the year. On 1 January 2015, the estimated number of employees who would exit was revised to 8%.

Actual information from the company's human resources department indicated that 24 employees exited during the year to 31 December 2014, 17 employees exited during the year to 31 December 2015 and 6 employees exited during the year to 31 December 2016.

**Required:**

- (i) Journal entries to record the transactions with regard to the share options for each of the years ended 31 December 2014, 31 December 2015 and 31 December 2016. (8 marks)
- (ii) Explain how your answer in (c) (i) above would be different if the employees had the option to be paid the cash equivalent to the market price of the shares vested. (2 marks)

**(Total: 20 marks)**

**QUESTION THREE**

Juhudi Ltd. is an electronics company which has been listed on the securities exchange for the last two years. Provided below are the equity and long-term funds of the company as at 30 April 2016.

Also provided are the income statements and statements of movements in reserves for the years ended 30 April 2016 and 30 April 2017 respectively.

**Equity and long-term funds as at 30 April 2016:**

	Sh. "000"
Ordinary share capital (Sh.8 par value)	19,200
Share premium	4,800
6% preference share capital	500
Retained profit	<u>3,240</u>
<b>Total equity</b>	<b>27,740</b>
<b>Long term funds:</b>	
8% convertible loan stock	<u>1,000</u>
<b>Total equity and non-current liabilities</b>	<b><u>28,740</u></b>

**Income statement for the year ended 30 April:**

	2017 Sh. "000"	2016 Sh. "000"
Revenue	25,100	21,720
Cost of sales	<u>(20,080)</u>	<u>(16,290)</u>
Gross profit	5,020	5,430
Operating expenses	<u>(1,220)</u>	<u>(1,200)</u>
Profit before interest and tax	3,800	4,230
Interest on loan stock	<u>(80)</u>	<u>(80)</u>
Profit before tax	3,720	4,150
Taxation	<u>(535)</u>	<u>(520)</u>
<b>Profit for the year</b>	<b><u>3,185</u></b>	<b><u>3,630</u></b>

**Statement of movements in reserves as at:**

	30 April 2017 Sh. "000"	30 April 2016 Sh. "000"
Retained profit brought forward	3,240	-
Profit for the year	3,185	3,630
Preference dividend	(30)	(30)
Ordinary dividend	<u>(480)</u>	<u>(360)</u>
<b>Retained profit carried forward</b>	<b><u>5,915</u></b>	<b><u>3,240</u></b>

**Additional information:**

1. On 1 November 2016, the company made a bonus issue of shares on the basis of one ordinary share for every six ordinary shares held.
2. On 1 March 2017, the company made a rights issue of one ordinary share for every seven ordinary shares held. The rights issue price was Sh.8.5 per share. The market value of one ordinary share on the date of the rights issue was Sh.12.5 per share.
3. The 8% convertible loan stock can be converted at the option of the holders from the year 2022 at the rate of 125 ordinary shares for every Sh.1,000 of the loan stock held.
4. The corporation tax rate is 30%.
5. There was no issue of preference share capital in the year 2017.
6. There was no issue of loan stock in the year 2017.

**Required:**

- (a) The basic earnings per share (EPS) for the year ended 30 April 2016. (2 marks)
  - (b) The basic earnings per share (EPS) for the year ended 30 April 2017. (8 marks)
  - (c) The adjusted earnings per share (EPS) for the year 2016 that would be shown in the year 2017 as a comparative for the EPS. (4 marks)
  - (d) The diluted earnings per share. (6 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) The management commentary (management discussion and analysis) provides users with integrated information that provides a context for the related financial statements.

**Required:**

Discuss three contents of a management commentary in an entity's financial statements. (6 marks)

- (b) Munro Ltd., a manufacturing company, provides for deferred income tax in accordance with IAS 12 (Income Taxes). The following is an extract from the statement of financial position as at 30 April 2017:

<b>Assets:</b>	<b>Sh."000"</b>
<b>Non-current assets:</b>	
Property, plant and equipment	14,000
Intangible assets	4,000
Goodwill	6,000
Financial assets – available for sale	12,000
<b>Current assets:</b>	
Inventories	7,500
Trade receivables	6,650
Prepayments	3,200
Cash and cash equivalents	<u>1,250</u>
	<b>54,600</b>
<b>Equity and liabilities:</b>	
<b>Equity:</b>	
Share capital	12,000
Revaluation reserves	3,000
Retained profit	12,260
<b>Non-current liabilities:</b>	
Interest-bearing loans	16,000
Deferred income tax (1 May 2016)	1,200
<b>Current liabilities:</b>	
Trade and other payables	8,000
Employee benefits	2,000
Current income tax	<u>140</u>
	<b>54,600</b>

**Additional information:**

1. The tax bases of the assets are as follows:
 

	<b>Sh."000"</b>
Property, plant and equipment	2,800
Prepayments	1,500
Interest-bearing loans	17,000
Financial assets (available for sale)	14,000
2. Inventories are stated at fair value less cost to sell which is lower than the original cost due to a general provision for price decline of Sh.3.5 million.
3. The intangible assets comprise development cost which is tax deductible when the amount is paid out. The cost of intangible assets was paid in the year 2014 and is presented net of amortisation cost.
4. Goodwill and employee benefits are tax exempt.
5. Trade and other payables include provision for leave allowance of Sh.1.4 million which is tax deductible on cash basis.
6. Trade receivables are stated net of general allowances for bad debts at the rate of 5% of the gross receivables. The general allowance is not tax deductible until it becomes specific.

7. The building, which is included in property, plant and equipment was revalued during the year. The increase in value of Sh.3 million does not affect the tax base.
8. The tax base of other items is equal to their carrying amount.
9. The tax rate applicable is 30%.

**Required:**

- (i) Deferred tax balance as at 30 April 2017. (12 marks)
- (ii) Deferred income tax account as at 30 April 2017. (2 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) Summarise three main reasons for developing a conceptual framework for the preparation and presentation of financial statements. (6 marks)
- (b) (i) In the context of International Public Sector Accounting Standard (IPSAS) 18 "Segment Reporting", differentiate between a "service segment" and a "geographical segment". (4 marks)
- (ii) IPSAS 25 "Employee Benefits" prescribes the accounting and disclosure requirements by public sector entities for employee benefits.

**Required:**

Explain three types of employee benefits with a brief description of the accounting treatment of each. (6 marks)

- (c) To maintain or create a good corporate image to the society within which a company operates, there is need to take responsibility for any actual or potential social impact caused by the company's activities. This should be reported through a social responsibility report.

**Required:**

Comparing conventional financial reporting with social responsibility reporting, explain two practical challenges peculiar to social responsibility reporting. (4 marks)

**(Total: 20 marks)**

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# KASNEB

## CPA PART III SECTION 6

### ADVANCED FINANCIAL REPORTING

FRIDAY: 25 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

H Ltd., a public limited company based in Kenya, owns 75% of the ordinary share capital of S Ltd., a public limited company based in Rwanda. H Ltd. acquired S Ltd. on 1 May 2015 for 1,200 million Rwandan Francs (RWF) when the retained profits of S Ltd. were 800 million RWF. The functional currency of H Ltd. is the Kenya shilling (KSh). The functional currency of S Ltd. is the Rwandan Franc (RWF). S Ltd. has not revalued its assets or issued any share capital since its acquisition by H Ltd. The following financial statements relate to H Ltd. and S Ltd.

#### Statement of financial position as at 30 April 2016:

	H Ltd. KSh. "million"	S Ltd. RWF "million"
<b>Assets:</b>		
Property, plant and equipment	2,970	1,460
Investment in S Ltd.	480	-
Loan to S Ltd.	50	-
Current assets	<u>3,550</u>	<u>1,020</u>
Total assets	<u>7,050</u>	<u>2,480</u>
<b>Equity and liabilities:</b>		
Ordinary shares of KSh.10/RWF 10	600	320
Share premium	500	200
Retained earnings	<u>3,600</u>	<u>950</u>
Total equity	4,700	1,470
Non-current liabilities	300	410
Current liabilities	<u>2,050</u>	<u>600</u>
Total equity and liabilities	<u>7,050</u>	<u>2,480</u>

#### Income statement and other comprehensive income

	H Ltd. KSh. "million"	S Ltd. RWF "million"
Revenue	2,000	1,420
Cost of sales	<u>(1,200)</u>	<u>(960)</u>
Gross profit	800	460
Distribution and administration expenses	<u>(300)</u>	<u>(200)</u>
Profit from operations	500	260
Interest receivable	40	-
Interest payable	<u>-</u>	<u>(20)</u>
Profit before tax	540	240
Income tax expense	<u>(200)</u>	<u>(90)</u>
Profit for the year	<u>340</u>	<u>150</u>

#### Additional information:

- Goodwill is reviewed for impairment annually. As at 30 April 2016, the impairment loss on recognised goodwill was RWF 42 million.
- During the year ended 30 April 2016, S Ltd. purchased raw materials from H Ltd. and denominated the purchase in RWF in its financial records. The details of the transaction are as shown below:

Nature of goods	Date of transaction	Selling price KSh. "million"	Profit percentage on selling price
Raw materials	1 February 2016	60	20%

As at 30 April 2016, half of the raw materials purchased were still in the inventory of S Ltd.

3. H Ltd. issued an interest-free loan to S Ltd. of KSh.50 million on 1 May 2015. The loan was repaid on 31 May 2016. S Ltd. included the loan in its non-current liabilities.
4. The fair value of the net assets of S Ltd. as at the date of acquisition is assumed to be the same as the carrying value.
5. H Ltd. paid a dividend of KSh.80 million during the year ended 30 April 2016. This dividend had not been included in the company's income statement.
6. The corporation tax rate is 30%.
7. It is the group's policy to value the non-controlling interest at acquisition at its proportionate share of the fair value of the subsidiary's identifiable net assets.
8. The following exchange rates are relevant to the financial statements:

	RWF to KSh.
30 April 2015/1 May 2015	2.5
1 November 2015	2.6
1 February 2016	2.0
30 April 2016	2.1
Average rate for the year ended 30 April 2016	2.0

**Required:**

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

- (a) Consolidated income statement for the year ended 30 April 2016. (10 marks)
  - (b) Consolidated statement of financial position as at 30 April 2016. (10 marks)
- (Total: 20 marks)**

**QUESTION TWO**

The following are the group income statement and group statement of financial position of Kijiko group of companies for the financial year ended 31 October 2016:

**Kijiko Group**

**Income statement for the year ended 31 October 2016**

	Sh."million"	Sh."million"
Revenue (from credit sales)		25,530
Cost of sales		<u>(18,140)</u>
Gross profit		7,390
Other incomes: Investment income	250	
Share of associate company's profit	<u>200</u>	<u>450</u>
		7,840
<b>Expenses:</b>		
Distribution costs	1,250	
Administrative expenses	2,640	
Finance costs	<u>750</u>	<u>(4,640)</u>
Profit before tax		3,200
Income tax expense		<u>(1,400)</u>
Profit for the year		<u><u>1,800</u></u>
Profit attributable to: Holding company		1,650
Non-controlling interest		<u>150</u>
		<u>1,800</u>

**Kijiko Group**

**Statement of financial position as at 31 October:**

	2016 Sh."million"	2015 Sh."million"
<b>Non-current assets:</b>		
Property, plant and equipment	3,800	3,050
Intangible assets (including goodwill)	2,500	2,000
Investments: In associate company	650	500
Others	<u>-</u>	<u>250</u>
	<u>6,950</u>	<u>5,800</u>

	2016 Sh."million"	2015 Sh."million"
<b>Current assets:</b>		
Inventories	1,500	1,020
Trade receivables	3,900	3,150
Short-term investments	500	-
Cash balance	<u>20</u>	<u>10</u>
Total assets	<u>12,870</u>	<u>9,980</u>
<b>Equity and liabilities:</b>		
Ordinary share capital	2,000	1,500
Revaluation reserve	1,010	910
Retained profits	1,740	1,200
Share premium	<u>1,600</u>	<u>1,500</u>
	6,350	5,110
Non-controlling interest	500	300
<b>Non-current liabilities:</b>		
Loan notes	1,700	500
<b>Current liabilities:</b>		
Trade payables	2,270	1,990
Bank overdraft	850	980
Current tax	<u>1,200</u>	<u>1,100</u>
Total equity and liabilities	<u>12,870</u>	<u>9,980</u>

**Additional information:**

- An item of plant with an original cost of Sh.850 million and with a net book value of Sh.450 million was sold for Sh.320 million during the year ended 31 October 2016.
- Other investments were sold for Sh.300 million during the year ended 31 October 2016.
- During the year ended 31 October 2016, Kijiko Ltd. acquired 80% of the share capital of Sahani Ltd. The assets of Sahani Ltd. were as follows as at the date of acquisition.

	Sh."million"
Property, plant and equipment	600
Inventories	400
Trade receivables	300
Loan notes	(250)
Trade payables	(400)
Bank balance	(100)
Tax	<u>(50)</u>
Net assets	<u>500</u>

- The following information relates to property, plant and equipment as at:

	31 October 2016 Sh."million"	31 October 2015 Sh."million"
Cost	7,200	5,950
Accumulated depreciation	<u>(3,400)</u>	<u>(2,900)</u>
Net book value	<u>3,800</u>	<u>3,050</u>

The cost of property, plant and equipment of Sahani Ltd. on the date of acquisition was Sh.1,000 million and the accumulated depreciation on the property, plant and equipment was Sh.400 million. During the year ended 31 October 2016, there was a revaluation gain of Sh.100 million attributable to the holding company's property, plant and equipment.

- The total purchase consideration of S Ltd. was Sh.450 million paid by issuing Sh.100 million worth of ordinary shares at par. The balance was paid in cash.
- Depreciation and loss on sale of plant are included in the cost of sales.

**Required:**

Group statement of cash flows in conformity with IAS 7 (Statement of Cash Flows) for the year ended 31 October 2016 using the direct method of presentation.

(20 marks)

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**QUESTION THREE**

(a) Explain four differences between an internal reconstruction and an external reconstruction.

(4 marks)

(b) The following is the summarised statement of financial position of P Ltd. as at 30 June 2016:

	Sh. "million"	Sh. "million"	Sh. "million"
<b>Non-current assets:</b>			
Tangible: Freehold property			680
Plant			<u>80</u>
			760
Intangible: Patents		244	
Goodwill		<u>224</u>	<u>468</u>
			1,228
<b>Current assets:</b>			
Inventory	680		
Accounts receivable	776		
Investment (market value Sh.224 million)	<u>88</u>	1,544	
<b>Current liabilities:</b>			
Accounts payable	400		
Bank overdraft	312		
Debenture interest payable	36		
Accruals	80		
Directors' loans	<u>160</u>	<u>(988)</u>	<u>556</u>
			1,784
<b>Financed by:</b>			
Share capital:			
120 million ordinary shares of Sh.10 each			1,200
6% 64 million cumulative preference shares of Sh.10 each			<u>640</u>
			1,840
<b>Revenue reserves:</b>			
Accumulated losses			<u>(656)</u>
			1,184
<b>Non-current liabilities:</b>			
6% debentures			<u>600</u>
			1,784

The court approved a scheme of reorganisation submitted by the debenture holders and agreed upon by other interested parties to take effect on 1 July 2016. Details of the approved scheme are as follows:

1. The 6% debenture holders were to have their interest paid in cash and to take over part of the freehold property (book value Sh.160 million) at a valuation of Sh.192 million in part repayment of their holding. The 6% debenture holders are also to provide additional cash of Sh.208 million secured by a floating charge on the company's assets at an interest rate of 12% per annum.
2. Patents and goodwill are to be written off, Sh.120 million is to be written off inventory and Sh.93.6 million is to be provided for bad debts. The remaining freehold property is to be revalued at Sh.620 million. The investment was sold at the prevailing market value.
3. The directors were to accept settlement of their loans as to 90% thereof by allotment of ordinary shares at par and as to 5% in cash. The balance of 5% was to be waived.
4. The trade payables are to be paid Sh.0.10 in every shilling to maintain and obtain an extension of the credit period.
5. The bank has sanctioned an overdraft limit of Sh.10 million to provide working capital.
6. The 6% preference dividends are four years in arrears of which three-quarters are to be waived and ordinary shares are to be allocated at par for the balance.
7. The 6% preference shares are to be written down to Sh.7.50 each and the existing ordinary shares to Sh.2 each. All the ordinary shares are to be consolidated into shares of Sh.10 each. The rate of dividends on preference shares is to be increased to 10%.
8. There are capital commitments amounting to Sh.600 million which are to be cancelled on payment of 3 1/3% of the contract price as a penalty.



**Required:**

- (i) The capital reduction account to record the scheme of capital reorganisation. (8 marks)
- (ii) The statement of financial position of P Ltd. as at the close of business on 1 July 2016 immediately after effecting the scheme of reorganisation. (8 marks)

**(Total: 20 marks)****QUESTION FOUR**

- (a) With reference to International Accounting Standard (IAS) 24 (Related Parties), explain three examples of related party relationships. (6 marks)

- (b) The following information relates to Jambo Ltd:

1. Net profit after tax:

Year ended 31 December:	2013	2014	2015
Sh. "million"	30	38	45

2. On 1 February 2014, a rights issue of one new share for each five shares outstanding was made at an exercise price of Sh.5.
3. Before the rights issue, the number of shares outstanding was 5,000,000.
4. The last date to exercise the rights was 1 March 2014.
5. The fair value of one ordinary share immediately before exercise of the rights on 1 March 2014 was Sh.11.

**Required:**

Earnings per share (EPS) for each of the years ended 31 December 2013, 2014 and 2015. (6 marks)

- (c) As part of its staff motivation programme, Better Ltd. decided to grant each of its 600 employees 100 options to purchase the company's shares effective from 1 April 2016. These options were conditional upon one still being in employment as at 31 March 2020.

The following additional details were provided with respect to the scheme:

Year ended	Number of employees expected to terminate or leave employment	Fair value of each option Sh.
31 March 2017	25	20
31 March 2018	15	16
31 March 2019	10	16
31 March 2020	10	12

The fair value of the option was Sh.25 as at 1 April 2016. The exercise price of the option will be Sh.12 and the par value of the company's share is Sh.6. The average market price of the share over the four years to 31 March 2020 is expected to be Sh.25.

**Required:**

Show how Better Ltd. should report the transactions of the above scheme as per the requirements of IFRS 2 (Share-based Payment) over the four years ending 31 March 2020. Assume that all the eligible employees will exercise their rights on 31 March 2020. (8 marks)

**(Total: 20 marks)****QUESTION FIVE**

- (a) Analyse three functions of the International Financial Reporting Interpretations Committee (IFRIC). (6 marks)

- (b) (i) Define the term "social responsibility accounting". (2 marks)

- (ii) Explain three advantages of social responsibility accounting. (6 marks)

- (c) The following summary of receipts and payments was extracted from the records of a hypothetical Ministry of Finance for the fiscal year ended 30 June 2016:

Receipts:	Original budget Sh. "billion"	Actual Sh. "billion"
Taxation revenue	320	300
Borrowings – foreign	180	180

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	Sh. "billion"	Sh. "billion"
Aid from international agencies	100	90
Disposal of assets	90	100
Trading activities	200	190
Other receipts	40	30
<b>Payments:</b>		
Education	180	170
Health	160	170
Defence	140	120
Housing	80	100
Internal security	120	120
Others	170	180

**Additional information:**

- The Minister for Finance presented the following supplementary finance bills which were approved and effected:
  - Disposal of a parastatal – Sh. 20 billion.
  - Domestic borrowings – Sh.30 billion.
  - Increase in expenditure for defence – Sh.10 billion.
  - Reduction in expenditure for health – Sh.15 billion.
- All the other receipts and payments remained as budgeted.

**Required:**

The statement of comparison of budget and actual amounts for the fiscal year ended 30 June 2016 in accordance with International Public Sector Accounting Standard (IPSAS) 24 (Presentation of Budget Information in Financial Statements).

(6 marks)

**(Total: 20 marks)**

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# KASNEB

## CPA PART III SECTION 6

### ADVANCED FINANCIAL REPORTING

FRIDAY: 27 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

On 1 April 2011, D Ltd. acquired 80% of the ordinary shares of S Ltd. S Ltd. had acquired 60% of the ordinary shares of E Ltd. on 1 July 2010.

D Ltd. had also invested in the ordinary shares of A Ltd. to the extent of 75% on 1 April 2012. On 30 June 2015, D Ltd. disposed of 1/3 of its investment in A Ltd.

The following financial statements relate to the above companies for the year ended 31 March 2016.

#### Statement of comprehensive income for the year ended 31 March 2016:

	D Ltd. Sh."million"	S Ltd. Sh."million"	E Ltd. Sh."million"	A Ltd. Sh."million"
Revenue	26,400	24,000	20,000	15,000
Cost of sales	(12,000)	(12,000)	(16,000)	(12,000)
Gross profit	14,400	12,000	4,000	3,000
Investment income	<u>3,520</u>	<u>540</u>	<u>-</u>	<u>-</u>
	17,920	12,540	4,000	3,000
Distribution cost	(3,320)	(2,360)	(1,360)	(800)
Administrative expenses	(3,880)	(2,440)	(1,140)	(900)
Finance cost	<u>(420)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Profit before tax	10,300	7,740	1,500	1,300
Income tax expenses	<u>(2,440)</u>	<u>(2,400)</u>	<u>(580)</u>	<u>(500)</u>
Profit for the year	7,860	5,340	920	800
Other comprehensive income:				
Adjustment of available for sale financial assets	<u>500</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total comprehensive income	<u><u>8,360</u></u>	<u><u>5,340</u></u>	<u><u>920</u></u>	<u><u>800</u></u>

#### Statement of financial position as at 31 March 2016:

	D Ltd. Sh."million"	S Ltd. Sh."million"	E Ltd. Sh."million"	A Ltd. Sh."million"
<b>Non-current assets:</b>				
Property, plant and equipment	8,760	2,200	4,500	3,500
Investment in: S Ltd.	6,720	-	-	-
E Ltd.	-	4,600	-	-
A Ltd.	4,480	-	-	-
Available for sale financial assets	<u>3,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>22,960</u>	<u>6,800</u>	<u>4,500</u>	<u>3,500</u>
<b>Current assets:</b>				
Inventories	2,100	2,200	1,650	1,270
Trade receivables	2,640	6,600	500	800
Financial assets at fair value through profit and loss	1,000	-	-	-
Cash and cash equivalents	<u>400</u>	<u>2,200</u>	<u>300</u>	<u>430</u>
	<u>6,140</u>	<u>11,000</u>	<u>2,450</u>	<u>2,500</u>
Total assets	<u><u>29,100</u></u>	<u><u>17,800</u></u>	<u><u>6,950</u></u>	<u><u>6,000</u></u>

	D Ltd. Sh. "million"	S Ltd. Sh. "million"	E Ltd. Sh. "million"	A Ltd. Sh. "million"
<b>Equity and liabilities:</b>				
<b>Equity:</b>				
Ordinary share capital (Sh.100 par value)	6,000	3,200	2,000	2,500
Share premium	3,000	1,600	1,000	1,250
Revenue reserves	<u>9,580</u>	<u>5,600</u>	<u>2,120</u>	<u>1,650</u>
	<u>18,580</u>	<u>10,400</u>	<u>5,120</u>	<u>5,400</u>
<b>Non-current liabilities:</b>				
12% loan stock	3,500	-	-	-
Deferred tax liability	2,660	2,200	370	-
<b>Current liabilities:</b>				
Trade and other payables	2,020	3,000	790	460
Current income tax	<u>2,340</u>	<u>2,200</u>	<u>670</u>	<u>140</u>
	<u>10,520</u>	<u>7,400</u>	<u>1,830</u>	<u>600</u>
Total equity and liabilities	<u>29,100</u>	<u>17,800</u>	<u>6,950</u>	<u>6,000</u>

**Additional information:**

- D Ltd. acquired its investments in S Ltd. and A Ltd. when the revenue reserve balances of S Ltd. and A Ltd. were Sh.2,600 million and Sh.650 million respectively.
- The revenue reserves of E Ltd. amounted to Sh.2,400 million as at 1 July 2010 and Sh.2,750 million as at 1 April 2011.
- During the year ended 31 March 2016, S Ltd. sold goods at a normal mark up of  $33\frac{1}{3}\%$  at a price of Sh.2,400 million to D Ltd. 20% of the goods remained unsold by D Ltd. as at 31 March 2016.
- The financial assets held at fair value through profit and loss in the books of D Ltd. have not been adjusted to their fair value of Sh.1,200 million. Revenue reserves of D Ltd. include the fair value adjustment of available for sale financial assets.
- Investment income includes dividends received from subsidiaries. D Ltd. received Sh.3,200 million from S Ltd. while S Ltd. received Sh.360 million from E Ltd. Total dividends paid by D Ltd. amounted to Sh.2,000 million.
- The disposal proceeds from the sale of shares in A Ltd. on 30 June 2015 amounted to Sh.1,500 million received in cash. D Ltd. will account for the remaining interest in A Ltd. using the equity method in accordance with IAS 28.
- Included in trade receivables and trade payables are the following balances:
  - Due from D Ltd. to S Ltd. Sh.250 million.
  - Due from A Ltd. to D Ltd. Sh.140 million.
  - Due from E Ltd. to S Ltd. Sh.240 million.
- Inventories sold by S Ltd. to D Ltd. worth Sh.60 million at normal mark up had neither been received nor recorded by D Ltd. as at 31 March 2016.
- All goodwill of the investee companies had been impaired by 25% during the year ended 31 March 2015. No impairment occurred in the year ended 31 March 2016. The group uses the partial goodwill method in preparing the group financial statements.

**Required:**

- Group statement of comprehensive income for the year ended 31 March 2016. (10 marks)
  - Group statement of financial position as at 31 March 2016. (10 marks)
- (Total: 20 marks)**

**QUESTION TWO**

The Samaki group has prepared the following financial statements for the year ended 31 December 2014 and 31 December 2015.

<b>Samaki Group</b>	
<b>Statement of comprehensive income for the year ended 31 December 2015</b>	
	Sh. "million"
Revenue	24,600
Cost of sales	<u>(19,230)</u>
	5,370
Other incomes: Share of profit after tax from associate	249
Gain on disposal of property, plant and equipment	45
Interest income	<u>141</u>
	5,805

	Sh. "million"	Sh. "million"
Distribution costs	2,406	
Administrative expenses	1,110	
Finance costs	<u>111</u>	(3,627)
Profit before tax		2,178
Income tax expense		<u>(594)</u>
Profit after tax for the year		<u>1,584</u>
Attributable to:		
Parent		1,254
Non-controlling interest		<u>330</u>
		<u>1,584</u>

**Samaki Group**  
Statement of financial position as at 31 December:

	2015 Sh. "million"	2014 Sh. "million"
<b>Assets:</b>		
<b>Non-current assets:</b>		
Property, plant and equipment	3,957	3,270
Goodwill	270	246
Investments	<u>2,340</u>	<u>810</u>
	<u>6,567</u>	<u>4,326</u>
<b>Current assets:</b>		
Inventories	2,400	1,914
Trade receivables	1,830	1,440
Cash and cash equivalents	<u>135</u>	<u>420</u>
	<u>4,365</u>	<u>3,774</u>
Total assets	<u>10,932</u>	<u>8,100</u>
<b>Capital and liabilities:</b>		
<b>Capital and reserves:</b>		
Ordinary share capital (Sh.10 par value)	540	450
Share premium account	255	45
Revaluation reserve	90	30
Retained earnings	597	306
Non-controlling interest	753	450
<b>Long-term liabilities:</b>		
Interest bearing borrowings	4,194	3,180
Current liabilities	<u>4,503</u>	<u>3,639</u>
	<u>10,932</u>	<u>8,100</u>

**Statement of changes in equity for the year ended 31 December 2015:**

	Share capital Sh. "million"	Share premium Sh. "million"	Revaluation reserve Sh. "million"	Retained earnings Sh. "million"	Total Sh. "million"
Balance brought down (1 January 2015)	450	45	30	306	831
Gain on revaluation of property	-	-	60	-	60
Net profit for the period	-	-	-	1,254	1,254
Dividend paid	-	-	-	(378)	(378)
Exchange difference: On retranslation of foreign investment	-	-	-	(615)	(615)
Exchange difference: On loan to finance equity investment	-	-	-	30	30
Issue of share capital	<u>90</u>	<u>210</u>	-	-	<u>300</u>
Balance carried down (31 December 2015)	<u>540</u>	<u>255</u>	<u>90</u>	<u>597</u>	<u>1,482</u>

**Additional information:**

- Samaki Ltd. acquired 80% of the ordinary shares in Zebra Ltd. on 1 January 2015. The fair value of the assets of Zebra Ltd. as at 1 January 2015 were as follows:

	Sh. "million"
Property, plant and equipment	180
Inventories	120
Trade receivables	45
Cash and cash equivalents	105
Trade payables	(48)
Accruals	(12)
Current tax	(90)
Net assets	<u>300</u>

The purchase consideration was Sh.291 million and comprised 6 million ordinary shares of Sh.10 par value in Samaki Ltd. (issued at Sh.40 each) and Sh.51 million in cash.

- The summary of property, plant and equipment was as follows:

	Sh. "million"
Balance as at 1 January 2015	3,270
Additions (including Zebra Ltd.)	834
Revaluation of property, plant and equipment	60
Disposal	(90)
Depreciation	<u>(117)</u>
Balance as at 31 December 2015	<u>3,957</u>

There have been no sales of investments. The investments included under non-current assets were made up of the following items as at 31 December:

	2015 Sh. "million"	2014 Sh. "million"
Investment in associate company	900	660
Trade investments (including purchases of foreign equity investment)	1,440	150

Interest receivable included in trade receivables was Sh.45 million as at 1 January 2015 and Sh.51 million as at 31 December 2015.

- Current liabilities comprised the following items as at 31 December:

	2015 Sh. "million"	2014 Sh. "million"
Trade payables (including interest payable of Sh.27 million as at 31 December 2015)	3,579	2,739
Current tax	609	600
Accruals	<u>315</u>	<u>300</u>
	<u>4,503</u>	<u>3,639</u>

- The exchange differences included in the statement of changes in equity relate to a transaction involving a foreign equity investment. An interest bearing loan of Sh.900 million was obtained during the year to finance the foreign equity investment. Both amounts are after retranslation as at 31 December 2015.
- During the year ended 31 December 2015, an interest bearing loan amounting to Sh.300 million was obtained to acquire additional property, plant and equipment. The assets were acquired in the course of the year.

**Required:**

The group statement of cash flow in accordance with IAS 7 (Statement of Cash Flows) for the year ended 31 December 2015.

(20 marks)

**QUESTION THREE**

Hasara Ltd., which has been operating in the telecommunications sector, has been posting successive trading losses. The directors of the company have made a proposal to reconstruct the company by transferring the entire operations of the company to a new entity to be called Zawadi Ltd. with effect from 1 April 2016.

The following statement of financial position relates to Hasara Ltd. as at 31 March 2016:

**Hasara Ltd.**  
**Statement of financial position as at 31 March 2016**  
**Sh. "000"**

<b>Assets:</b>	
<b>Non-current assets:</b>	
Property, plant and equipment	10,957.4
Available for sale financial assets	647
Goodwill	120
Preliminary expenses	87.8

<b>Current assets:</b>	<b>Sh. "000"</b>
Inventories	872.5
Accounts receivable	689.9
Financial assets at fair value through profit and loss	<u>216.4</u>
Total assets	<u>13,591</u>
<b>Equity and liabilities:</b>	
<b>Equity:</b>	
Ordinary share capital (Sh.10 par value)	6,000
7% cumulative preference share capital (Sh.10 par value)	4,000
Revaluation reserves	400.8
Revenue reserves	<u>(3,822.7)</u>
	6,578.1
<b>Non-current liabilities:</b>	
10% debentures	4,000
<b>Current liabilities:</b>	
Bank overdraft	775.8
Accounts payable	1,962
Current income tax	<u>275.1</u>
<b>Total equity and liabilities</b>	<u>13,591</u>

**Additional information:**

1. Zawadi Ltd. issued 3 new ordinary shares of Sh.10 each for every five 7% cumulative preference shares in Hasara Ltd. In addition, the 7% cumulative preference shareholders in Hasara Ltd. were issued with two new 10% preference shares of Sh.10 par value in Zawadi Ltd. for every five 7% cumulative preference shares held.
2. The preference dividends in Hasara Ltd. were three years in arrears. The 7% cumulative preference shareholders in Hasara Ltd. will accept three fully paid ordinary shares of Sh.10 each in Zawadi Ltd. and Sh.20 of 8% debentures in Zawadi Ltd. for every Sh.100 of the preference dividend in arrears.
3. The existing 10% debenture holders in Hasara Ltd. were issued with five fully paid ordinary shares of Sh.10 each in Zawadi Ltd. and Sh.40 of 8% debentures for every Sh.100 of 10% debentures.
4. The ordinary shareholders in Hasara Ltd. were issued with 2 new ordinary shares of Sh.10 each in Zawadi Ltd. for every five ordinary shares held.
5. The current liabilities of Hasara Ltd. were taken over by Zawadi Ltd. at book value.
6. The assets of Hasara Ltd. were taken over by Zawadi Ltd. at their fair values as follows:

	<b>Sh. "000"</b>
Property, plant and equipment	9,486.8
Available for sale financial assets	810
Inventories	608.7
Accounts receivable	477.1
Financial assets at fair value through profit and loss	216.4

7. The liquidation expenses of Hasara Ltd. amounted to Sh.30,000 and were paid by Zawadi Ltd.
8. All the above transactions were completed on 1 April 2016.

**Required:**

- (a) The relevant ledger accounts to close the books of Hasara Ltd. (8 marks)
  - (b) Journal entries to record the relevant transactions in the books of Zawadi Ltd. (6 marks)
  - (c) Statement of financial position of Zawadi Ltd. as at 1 April 2016. (6 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) With reference to IAS 36 (Impairment of Assets), discuss the treatment of impairment losses. (6 marks)
- (b) In the context of IPSAS 4 (The Effects of Changes in Foreign Exchange Rates), explain the procedure to be adopted when translating the financial performance and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy into a different presentation currency. (6 marks)

(c) XYZ Ltd. issued share options to staff on 1 January 2013. The details relating to these share options are as follows:

Number of staff	1,000
Number of options to each member of staff	500
Vesting period	3 years
Fair value at grant date (per option)	Sh.30
Expected employee turnover (per annum)	5%

**Additional information:**

1. In the financial statements for the year ended 31 December 2014, the company revised its estimate of employee turnover to 8% per annum for the three-year vesting period.
2. In the financial statements for the year ended 31 December 2015, the actual employee turnover had averaged 6% per annum for the three-year vesting period.
3. Options vest as long as the staff remain with the company for the three-year period.

**Required:**

The charge to be made to the statement of comprehensive income for share-based payments, in conformity with the requirements of IFRS 2 (Share-based Payment) for each of the years ended 31 December 2013, 31 December 2014 and 31 December 2015. (8 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Discuss the rationale for a regulatory framework in financial reporting. (6 marks)
- (b) Explain how the International Accounting Standards Board (IASB) approaches the task of producing a standard, with particular reference to the development and publication of an exposure draft. (8 marks)
- (c) In the context of recent trends in financial accounting and reporting, explain why "social accounting and reporting" has gained prominence. (6 marks)

**(Total: 20 marks)**

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# KASNEB

## CPA PART III SECTION 6

### ADVANCED FINANCIAL REPORTING

FRIDAY: 27 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) In the context of IFRS 3 (Business Combinations), discuss how non-controlling interests (NCI) are measured. (4 marks)
- (b) On 1 April 2015, H Ltd. acquired 75% of the equity shares of F Ltd. through a share exchange of three shares in H Ltd. for every five shares in F Ltd. The nominal value of each share for both H Ltd. and F Ltd. is Sh.5. The shares of these companies were trading in the securities exchange at Sh.30 and Sh.16 for H Ltd. and F Ltd. respectively. On the same date, H Ltd. acquired 30% of the equity shares of N Ltd. paying Sh.10 per share. The nominal value of each share of N Ltd. is Sh.5.

The statements of comprehensive income for the three companies for the year ended 30 September 2015 are as set out below:

	H Ltd. Sh."million"	F Ltd. Sh."million"	N Ltd. Sh."million"
Sales revenue	1,680	1,200	400
Cost of sales	(630)	(500)	(250)
Gross profit	1,050	700	150
Distribution cost	(89.6)	(56)	(70)
Administrative expenses	(146.4)	(72)	(128)
Finance costs	(14.4)	(24)	-
	799.6	548	(48)
Investment income	76	-	-
Profit before tax	875.6	548	(48)
Income tax	(120)	(80)	8
Profit/loss after tax	755.6	468	(40)

The summarised equity information for the three companies as at 30 September 2015 is given below:

	H Ltd. Sh."million"	F Ltd. Sh."million"	N Ltd. Sh."million"
Ordinary share capital (Sh.5 par value)	1,600	960	320
Share premium	2,400	-	-
Retained earnings (1 October 2014)	320	1,216	120
Profit/loss for the year ended 30 September 2015	755.6	468	(40)
Dividend paid (20 September 2015)	-	64	-

#### Additional information:

- On 1 April 2015, H Ltd. invested Sh.100 million in 10% debentures of F Ltd. All interest accruing to 30 September 2015 had been accounted for by both companies. F Ltd. also had other loans in issue as at 30 September 2015.
- During the year ended 30 September 2015, H Ltd. sold goods to F Ltd. for Sh.120 million at a mark-up of 25%. One third of these goods were still in the inventory of F Ltd. as at 30 September 2015.
- As at 30 September 2015, the investment of H Ltd. in N Ltd. had been impaired by Sh.24 million owing to the losses that N Ltd. had been incurring. Any goodwill arising on H Ltd.'s investment in F Ltd. is not impaired.
- An item of plant of F Ltd. had a carrying amount of Sh.96 million and a fair value of Sh.136 million as at the date of acquisition. This plant had a remaining life of five years as at the date of acquisition of the shareholding in F Ltd. All other assets of F Ltd. had fair values which were equal to their carrying values as at the date of acquisition.

5. F Ltd. owned a registered trade mark with a remaining useful life of five years as at the date of acquisition. This trade mark was valued by a specialist at Sh.40 million as at this date. This registered trade mark had not been reflected in the financial statements of F Ltd.
6. H Ltd. had included the whole of the dividend it received from F Ltd. in its investment income.
7. No fair value adjustments were required on the acquisition of the investment in N Ltd.
8. The non-controlling interest in F Ltd. was to be valued at its full fair value as at the date of acquisition.
9. Incomes and expenses of all the three companies were deemed to accrue evenly throughout the year unless otherwise indicated.

**Required:**

- (i) Goodwill on the acquisition of H Ltd.'s shareholding in F Ltd. (4 marks)
  - (ii) Consolidated statement of comprehensive income for the year ended 30 September 2015. (12 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) Integrated reporting (IR) is aimed at promoting a more cohesive and efficient approach to corporate reporting. It serves to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.

With reference to the above statement, highlight six content elements that an integrated report should contain.

(6 marks)

- (b) Tabu Ltd. is a private company. Three quarters of the issued share capital of the company are held by the directors and members of their immediate family. The company's draft statement of financial position as at 31 December 2014 was as follows:

	Sh. "000"	Sh. "000"
<b>Non-current assets:</b>		
Intangible assets: Development costs		85,000
		Goodwill 60,000
Tangible assets: Buildings		270,000
		<u>Plant and machinery 326,000</u>
		741,000
<b>Current assets:</b>		
Inventories	426,000	
Trade receivables	<u>531,000</u>	957,000
<b>Current liabilities:</b>		
Trade payables	393,000	
Bank loans and overdrafts	<u>687,000</u>	<u>(1,080,000)</u>
Net assets		<u>618,000</u>
<b>Equity:</b>		
Ordinary share capital (Sh.10 par)		800,000
Share premium		50,000
Accumulated losses		<u>(232,000)</u>
Net equity		<u>618,000</u>

Bank loans and overdrafts consist of a 10% loan of Sh.400 million carrying a fixed charge on the company's buildings and an unsecured overdraft of Sh.287 million.

The demand for the company's products has fallen drastically in recent years, owing to the importation of high quality and cheaper alternative products from South-East Asia. The development costs appearing in the statement of financial position relate to a new product that has been perfected to a marketable stage and for which there is believed to be a strong demand. These costs have been properly capitalised in accordance with the provisions of IAS 38 (Intangible Assets). The company is in urgent need of capital to meet existing liabilities and the necessary new investment in plant and working capital.

A scheme of reorganisation has been drawn up for consideration by the shareholders and creditors. The terms of this scheme are as follows:

1. The shares of Sh.10 each are to be written down to Sh.2 per share and subsequently every five shares of Sh.2 each consolidated into one fully paid share of Sh.10.

2. The existing shareholders are to subscribe for a rights issue of two new Sh.10 ordinary shares at par for every share held after the proposed reduction and consolidation.
3. A major supplier agrees to exchange a debt of Sh.180 million included in trade payables for 18 million ordinary shares of Sh.10 par value.
4. In full satisfaction of the Sh.687 million owing to the bank, the bank agrees to accept an immediate payment of Sh.87 million and to consolidate the balance of Sh.600 million into a loan carrying interest at 13% per annum, payable in five equal annual installments commencing 31 December 2016. The loan is to be secured by a fixed charge on the buildings and a floating charge on the company's remaining assets.
5. The credit balance on the share premium account and the accumulated losses and goodwill, considered valueless, are to be written off.
6. The assets listed below are to be restated to the following amounts:
 

	Sh. "000"
Plant and machinery	125.000
Inventories	210.000
Trade receivables	500.000
Buildings	320.000
7. A group of dissatisfied shareholders plan to oppose the scheme because they feel they have borne an inordinate burden of reorganisation whereas the bank has lost nothing.
8. The company has received a cash offer of Sh.1,120 million for its non-current and current assets.

**Required:**

- (i) The revised statement of financial position of Tabu Ltd. as at 1 January 2015 after conclusion of the proposed scheme of reorganisation. (10 marks)
  - (ii) A report to the group of dissatisfied shareholders advising on whether they should accept or reject the scheme of reorganisation. (4 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Compare and contrast the relative merits of the "direct method" and the "indirect method" of presentation of the statement of cash flows. (4 marks)
- (b) Mawingu Group has prepared the following financial statements for the year ended 31 October 2014 and 31 October 2015:

**Mawingu Group**  
**Statement of comprehensive income for the year ended 31 October 2015:**

	Sh. "million"	Sh. "million"
Revenue		31,116
Cost of sales		<u>(22,936)</u>
Gross profit		8,180
Other incomes: Share of profit in associate company		160
Investment income		<u>200</u>
		8,540
<b>Expenses:</b>		
Administration expenses	3,560	
Distribution costs	1,820	
Finance cost	<u>600</u>	<u>(5,980)</u>
Profit before tax		2,560
Taxation		<u>(1,120)</u>
Profit for the year		<u>1,440</u>
Profit attributable to:		
The holding company		1,320
Non-controlling interest		<u>120</u>
		<u>1,440</u>

**Mawingu Group**  
**Statement of financial position as at 31 October:**

	2015 Sh. "million"	2014 Sh. "million"
<b>Non-current assets:</b>		
Property, plant and equipment	3,080	2,480
Intangibles (including goodwill)	1,960	1,560
Investments - In associate company	520	400
Other investments	<u>-</u>	<u>200</u>
	5,560	4,640
<b>Current assets:</b>		
Inventories	1,400	1,016
Trade receivables	2,920	2,320
Financial assets at fair value	400	-
Cash in hand	<u>16</u>	<u>8</u>
<b>Total assets</b>	<b><u>10,296</u></b>	<b><u>7,984</u></b>
<b>Capital and liabilities:</b>		
Ordinary share capital	1,680	1,280
Share premium	1,200	1,120
Revaluation reserve	800	728
Retained profit	<u>1,400</u>	<u>960</u>
	5,080	4,088
Non-controlling interest	400	240
<b>Non-Current liabilities:</b>		
Debentures	1,360	400
<b>Current liabilities:</b>		
Trade payables	1,616	1,392
Accrued expenses	200	200
Bank overdraft	680	784
Taxation	<u>960</u>	<u>880</u>
<b>Total capital and liabilities</b>	<b><u>10,296</u></b>	<b><u>7,984</u></b>

**Additional information:**

- Some items of machinery with an original cost of Sh.680 million and a net book value of Sh.360 million were sold for Sh.256 million during the year ended 31 October 2015.

The following information relates to property, plant and equipment:

	31 October 2015 Sh. "million"	31 October 2014 Sh. "million"
Cost	5,800	4,800
Depreciation	<u>(2,720)</u>	<u>(2,320)</u>
Net book value	3,080	2,480

- During the year ended 31 October 2015, Mawingu group acquired 80% of the share capital of Mwewe Ltd. The net assets of Mwewe Ltd. were as follows as at the date of acquisition:

	Sh. "million"
Property, plant and equipment	480
Inventories	400
Trade receivables	<u>160</u>
	1,040
Debentures	(320)
Trade payables	(200)
Bank balance	(80)
Taxation	<u>(40)</u>
	<u>400</u>

- The cost of the property, plant and machinery of Mwewe Ltd. on the date of acquisition was Sh.800 million and the accumulated depreciation was Sh.320 million. During the year ended 31 October 2015, there was a revaluation gain of Sh.80 million attributable to the holding company's property, plant and machinery.

4. The other investments were sold for Sh.240 million during the year.
5. The total purchase price of the 80% shareholding in Mwewe Ltd. was Sh.360 million which was paid by issuing Sh.80 million worth of shares at par value with the balance being paid in cash.

**Required:**

The group statement of cash flows, using the indirect method, for the year ended 31 October 2015 in conformity with the requirements of IAS 7 (Statement of Cash Flows).

(16 marks)

(Total: 20 marks)

**QUESTION FOUR**

- (a) In the context of IAS 38 (Intangible Assets), discuss the accounting treatment of brands in an entity's books of account. (6 marks)
- (b) Evaluate the potential problems that an investor might encounter in placing undue emphasis on the earnings per share (EPS) figure. (4 marks)
- (c) Winam Ltd., a limited company, has an authorised share capital of Sh.4,000 million comprising 600 million ordinary shares each of Sh.5 par value and 50 million 10% convertible preference shares each of Sh.20 par value.

On 1 January 2013, the company had in issue 160 million ordinary shares and 30 million 10% convertible preference shares.

All the preference shares were fully paid while only 100 million ordinary shares were fully paid, the balance of the shares being 80% paid.

The following transactions took place in the years ended 31 December 2013 and 31 December 2014:

1. The partly paid ordinary shares of Sh.5 par value were fully paid on 1 April 2013.
2. On 1 June 2013, the company issued for consideration 72 million ordinary shares of Sh.5 par value at Sh.8 each in full settlement, the market price of the ordinary shares on this day being Sh.10 per share.
3. On 1 September 2013, the company issued 48 million ordinary shares of Sh.5 each at fair value of Sh.12 per share in settlement of the purchase consideration on the acquisition of property.
4. On 1 March 2014, the company issued one fully paid bonus share for every 5 ordinary shares outstanding as at 31 December 2013.
5. Due to low market price per ordinary share at the securities exchange, the company decided to effect a consolidation of the shares (reverse split) and issued one new ordinary share of Sh.10 par value for every two outstanding and fully paid ordinary shares of Sh.5 par value. This was done on 1 August 2014.
6. On 1 October 2014, holders of 10 million 10% convertible preference shares converted these shares into ordinary shares. The preference shares were convertible into eight fully paid ordinary shares of Sh.5 for every two fully paid 10% preference shares of Sh.20 each. An appropriate adjustment for the number of ordinary shares issuable on conversion of preference shares is to be effected for any ordinary share split or consolidation that may be carried out. Preference shareholders are entitled to dividends up to the date of conversion of the shares.
7. The company made a net profit after tax of Sh.225.75 million in the year ended 31 December 2013 and Sh.262.6 million in the year ended 31 December 2014.

**Required:**

- (i) Basic Earnings Per Share (EPS) for each of the two years ended 31 December 2013 and 31 December 2014. (8 marks)
  - (ii) The restated Basic Earnings Per Share (EPS) for the year ended 31 December 2013 as at 31 December 2014. (2 marks)
- (Total: 20 marks)

**QUESTION FIVE**

- (a) With reference to IPSAS 9 (Revenue from Exchange Transactions), differentiate between "exchange transactions" and "non-exchange transactions". (4 marks)
- (b) Directors, as key decision-makers, should oversee the implementation of high standards throughout the financial reporting process. They should work with management to implement a principled and transparent accounting system that effectively collates and reports financial data across the company's supply chain.

In the context of the above observation, highlight four items of information that should be included in a directors' report. (4 marks)

(c) Evaluate three factors that a country should consider in deciding whether it would be in its best interests to develop its own accounting standards. (6 marks)

(d) ABC Ltd. has granted 100 share options to each of its 500 employees. Each grant is conditional upon the employee working for the company over the next three years. The company estimates that the fair value of each share option is Sh.15.

The company also estimates that 20% of the employees will leave during the three-year period and, therefore, forfeit their rights to the share options.

**Required:**

Determine how ABC Ltd. would account for the share options in each of the three years in accordance with the requirements of IFRS 2 (Share-based Payment). (6 marks)

**(Total: 20 marks)**

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# KASNEB

## CPA PART III SECTION 6

### ADVANCED FINANCIAL REPORTING

#### PILOT PAPER

September 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

Khan Ltd. operates in the media sector. The company has invested in two other companies. The draft statements of financial position as at 30 April 2015 for Khan Ltd. and its investee companies Choby Ltd. and Ghax Ltd. were as presented below:

	Khan Ltd. Sh."million"	Choby Ltd. Sh."million"	Ghax Ltd. Sh."million"
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	6,590	4,000	2,400
Investments in:	3,350		
Choby Ltd.	1,400		
Ghax Ltd.	<u>11,340</u>	<u>4,000</u>	<u>2,400</u>
Current assets	<u>1,970</u>	<u>1,722</u>	<u>300</u>
	<u>13,310</u>	<u>5,722</u>	<u>2,700</u>
<b>Equity and liabilities</b>			
Ordinary share capital	1,700	2,040	1,200
Retained earnings	6,680	1,960	700
Other reserves	<u>500</u>	<u>160</u>	<u>80</u>
	<u>8,880</u>	<u>4,160</u>	<u>1,980</u>
Non-current liabilities	3,790	1,350	400
Current liabilities	<u>640</u>	<u>212</u>	<u>320</u>
	<u>13,310</u>	<u>5,722</u>	<u>2,700</u>

#### Additional information:

1. Khan Ltd. acquired 30% of Choby Ltd. on 1 May 2012 for a cash consideration of Sh.1,200 million when the fair value of Choby Ltd.'s identifiable assets was Sh.3,680 million. Khan Ltd. treated the investment as an associate up to 1 May 2014 when its share of post acquisition profits in Choby stood at Sh.180 million and its share of post acquisition revaluation reserve was Sh.20 million. On this date Khan Ltd. acquired a further 40% of the ordinary shares of Choby Ltd. for a cash consideration of Sh.1,950 million thereby acquiring control.
2. On 1 May 2014, the fair value of Choby Ltd.'s identifiable net assets was Sh.4,500. The fair value of the interest in Choby Ltd. held by Khan Ltd. before the combination was Sh.1,410 million and the fair value of the 30% non controlling interest was assessed at Sh.1,240 million. Retained earnings of Choby Ltd. on 1 May 2014 and its other reserves were Sh.1,800 million and Sh.140 million respectively. Non controlling interest is measured at fair value in group financial statements.
3. On the date of the business combination with Choby Ltd., Khan Ltd. included in the fair value of Choby Ltd. an unrecognised contingent liability in respect of a legal claim against Choby Ltd. in the amount of Sh.12 million. The amount was revised on 1 August 2014 to Sh.10 million. The amount has met the criteria for recognition as a provision under current liabilities and the revision estimate is deemed to be a measurement period adjustment.
4. In addition, buildings with a carrying amount of Sh.400 million and had been included in the fair value of Ghoby Ltd. on 1 May 2014. The buildings had a remaining useful life of 20 years on that date and Khan Ltd. had commissioned an independent valuation which was subsequently received on 1 September 2014 resulting in a decrease of Sh.80 million in the property, plant and equipment of Choby Ltd. on acquisition date. This decrease did not affect the fair value of the non controlling interest and has not been reflected in the financial statements. The excess of fair value of net assets over the carrying value on 1 May 2014 is due to an increase in the value of non depreciable land and the contingent liability.
5. On 1 May 2014, Khan Ltd. acquired 80% of the equity interest of Ghax Ltd. paying Sh.1,400 million in cash. The fair value of net identifiable assets was Sh.1,920 million and the fair value of non controlling interest on this date was Sh.500 million. The retained earnings and other reserves of Ghax Ltd. on acquisition date were Sh.600 million and Sh.80 million respectively. The excess in fair value is due to an unrecognised franchise right which Khan Ltd. granted to Ghax Ltd. on 1 May 2013 for 5 years. On the date of acquisition, the franchise could be sold at market value.

6. On 30 April 2014, Khan Ltd. carried a property in its financial statements at its revalued amount of Sh.28 million. Depreciation is charged at Sh.600,000 per annum on a straight line basis. In August 2014, the management decided to sell the asset and it was advertised for sale and by 31 August 2014 the sale was considered highly probable and the criteria for non-current assets held for sale was met. On this date, fair value of the asset was Sh.30.8 million and its value in use was Sh.31.6 million. Costs to sell the asset were estimated at Sh.600,000. On 30 April 2015, the asset was sold for Sh.31.2 million. No entries have been made as the cash proceeds on the sale were not received until 31 May 2015. This transaction is deemed material.

**Required:**

Consolidated statement of financial position for Khan group as at 30 April 2015.

(20 marks)

**QUESTION TWO**

Cindy Ltd.'s trial balance as at 30 June 2015 was as follows:

	Sh. "000"	Sh. "000"
Revenue		320,250
Cost of sales	205,200	
Distribution costs	26,250	
Administrative expenses	28,500	
Interest on loan note	2,250	
Investment income		600
Ordinary shares Sh.0.50 each		90,000
6% loan note		37,500
Retained earnings 1 July 2014		6,450
Land and buildings (land Sh.15 million)	75,000	
Plant and equipment at cost	125,550	
Accumulated depreciation 1 July 2014:		
- Buildings		12,000
- Plant and equipment		50,550
Financial asset carried at fair value	25,500	
Inventory	37,200	
Trade receivables	42,750	
Bank	4,350	
Current tax	1,650	
Deferred tax		1,800
Trade payables		55,050
	<u>574,200</u>	<u>574,200</u>

**Additional information:**

- On 1 July 2014, Cindy Ltd. sold one of its products for Sh.15 million (included in revenue) and committed to provide ongoing service and maintenance for three years from the date of transaction. The estimated servicing cost is Sh.900,000 per annum and Cindy Ltd.'s gross profit margin on this type of servicing is 25%. Ignore discounting.
- Cindy Ltd. issued a Sh.37.5 million 6% loan on 1 July 2014. Issue costs were Sh.3 million included in administrative expenses. Interest is paid annually on 30 June each year. The loan will be redeemed on 30 June 2017 at a premium which gives an effective interest rate of 8%.
- Cindy Ltd. has been carrying land and buildings at depreciated cost using the cost model. However, due to a recent rise in prices the company decided to revalue its property on 1 July 2014. A professional valuer confirmed the value of property at Sh.90 million (land element Sh.18 million) on that date. Property had a remaining useful life of 16 years and deferred tax on the revaluation is to be adjusted in the income statement from the profits for the year.
- On 1 July 2014, Cindy Ltd. had a processing plant installed at a cost of Sh.15 million included in the cost of plant in the trial balance. The process the plant performs will cause immediate contamination of nearby land. Cindy Ltd. will have to clean up this land at the end of the plant's ten year life. The present value of the clean up discounted at 10% per annum was Sh.9 million on 1 July 2014 and the company has not recorded this cost. This plant is depreciated at 10% per annum on straight line basis.  
All other plant and equipment are depreciated at 12.5% per annum on a reducing balance basis. All depreciation is charged to the cost of sales and amounts for the current year have not been charged.
- The fair value of investments was Sh.23.55 million on 30 June 2015.
- The balance on current tax represents under/overprovision of tax liability for the year ended 30 June 2014. Current tax provision for the year ended 30 June 2015 is estimated at Sh.11.1 million. Cindy Ltd. had taxable temporary differences amounting to Sh.7.5 million on 30 June 2015.
- Corporate tax rate was 30%.



**Required:**

In a format and classification suitable for publication:

- (a) Statement of comprehensive income for the year ended 30 June 2015. (12 marks)
- (b) Statement of financial position as at 30 June 2015. (8 marks)
- (Total: 20 marks)**

**QUESTION THREE**

- (a) Galvin Ltd. purchased a zero coupon bond for Sh.600,000 redeemable in five years on 1 January 2014. The effective interest rate is 10% and the bond is carried at amortised cost.

**Required:**

- (i) Valuation of the bond to be reflected in the statement of financial position as at 31 December 2015. (3 marks)
- (ii) Finance income for the year ending 31 December 2015. (3 marks)
- (b) Sophistic Ltd., a newly listed company has provided the following information with regards to computation of its tax expense for the year ended 31 May 2014:

	<b>Sh. "000"</b>
Accounting profit	42,900
Depreciation	6,000
Donations	1,000
Amortisation of software	<u>2,400</u>
	52,300
Capital allowances	<u>(7,500)</u>
	<u>44,800</u>
Tax expense - at 25%	<u>11,200</u>

The company has not yet determined tax expense for the year ended 31 May 2015.

**Additional information:**

1. Accounting profit for the year ended 31 May 2015 was Sh.55,200,000 while donations amounted to Sh.600,000.
2. An extract of non-current assets movement schedule for the year ended 31 May 2015 was as follows:

	<b>Plant</b>	<b>Software</b>
Cost 1 June 2014	32,000	9,000
Additions during the year	-	-
Accumulated depreciation 1 June 2014	19,200	5,400
Tax written down value 1 June 2014	18,500	?

3. Plant is depreciated at 20% per annum using the straight line method while wear and tear allowance on plant is provided at 25% on a reducing balance basis.
4. Software development commenced in the year ended 31 May 2011 and was completed in the immediate subsequent year. The company capitalised development costs which amounted to Sh.9,000,000 and amortisation commenced on 1 June 2012 using the sum of digits method over the estimated useful life of 5 years. Software development costs are allowed in full for tax purposes in the year in which they are incurred.
5. Donations made by the company were not tax allowable.
6. Corporate tax rate applicable on the company's earnings for the year ended 31 March 2015 is 30% and the company is expected to continue generating taxable profits in the foreseeable future.

**Required:**

- (i) Current tax to be charged in the income statement for the year ended 31 May 2015. (4 marks)
- (ii) Deferred tax liability to be reflected in the statement of financial position as at 31 May 2014. (4 marks)
- (iii) Deferred tax liability account for the year ended 31 May 2015. (6 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) Volta Ltd. operates a defined retirement benefit plan for its employees. On 1 January 2014, the fair value of the pension plan assets was Sh.2,600,000 and the present value plan liabilities were Sh.2,900,000.

The actuary estimated current and past service costs for the year ended 31 December 2014 at Sh.450,000 and Sh.90,000 respectively. The past service cost is caused by an improvement in pension benefits commencing 31 December 2014.

The pension plan paid Sh.240,000 on 31 December 2014 and on the same date Volta Ltd. paid Sh.730,000 in contributions to the plan.

Interest rate on high quality corporate bonds for the year was 8%.

As at the year end fair value of pension plan assets was Sh.3,400,000 and present value plan liabilities were Sh.3,500,000.

In accordance with year 2011 revision to IAS 19 Employee Benefits, Volta Ltd. recognises measurement gains and losses in other comprehensive income in the period they occur.

**Required:**

Calculate the measurement gains or losses on pension plan assets and liabilities that will be included in other comprehensive incomes for the year ended 31 December 2014. (6 marks)

(b) Ozen Ltd. is a manufacturing company quoted on the securities exchange. The following information was extracted from the records of the company:

1. On 1 January 2013, the company had an issued and outstanding share capital of 300,000 ordinary shares of Sh.20 each and 100,000 8% convertible preference shares of Sh.50 each. All ordinary shares were fully paid and the preference shares were convertible into ordinary shares at the rate of 3 ordinary shares for every two preference shares fully paid.
2. The company reported profits after tax of Sh.1,200,000 in the year ended 31 December 2013 and Sh.1,800,000 in the year ended 31 December 2014. The profit for the year ended 31 December 2014 is after inclusion of a profit of Sh.250,000 from operations discontinued in the period.
3. On 1 April 2013 the company made a rights issue of one fully paid ordinary share at Sh.60 for every 3 ordinary shares when the shares were trading at Sh.84. each.
4. On 1 October 2013 the company issued 200,000 ordinary shares at market price.
5. Due to the high market price of its shares Ozen Ltd. split its shares in the ratio of two fully paid ordinary shares of Sh.10 each for every one ordinary share of Sh.20 each on 1 April 2014.
6. The company offered 200,000 stock options on 1 June 2014 with an exercise price of Sh.30 when the average market price per share was Sh.40 in the year. None of the options were exercised.
7. On 1 July 2014 the company issued 8% convertible debentures amounting to Sh.4 million. The debentures were convertible into ordinary shares at the rate of 60 fully paid ordinary shares for every Sh.1,000 of the debentures. None of the debentures were converted in the year ended 31 December 2014.
8. The company had issued 6% debentures with a nominal value of Sh.5 million in the year 2010. The debentures were convertible into ordinary shares at the rate of 60 fully paid ordinary shares for every Sh.1,000 of the debentures. None of the debentures had been converted by 31 December 2013. However, on 1 October 2014 holders of Sh.3 million debentures converted them to ordinary shares.
9. Corporate tax rate was 30%.

**Required:**

(i) Basic EPS for each of the years ended 31 December 2013 and 2014. (8 marks)

(ii) Diluted EPS for the year ended 31 December 2014. (6 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

(a) In line with IPSAS 23 - Revenue from Non Exchange transactions:

(i) Distinguish between exchange transactions and non exchange transactions. (4 marks)

(ii) Enumerate four examples of non exchange transactions. (4 marks)

(b) Explain the contents of the following reports:

(i) Environmental report. (6 marks)

(ii) Directors report. (6 marks)

**(Total: 20 marks)**

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