

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

**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	-	250
	6,950	5,800

	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)



**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:

- 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.
- 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.
- 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.
- The trade payables are to be paid Sh.0.10 in every shilling to maintain and obtain an extension of the credit period.
- The bank has sanctioned an overdraft limit of Sh.10 million to provide working capital.
- 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.
- 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%.
- 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

	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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