

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"
Non-current assets:				
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>
Current assets:				
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"
Equity and liabilities:				
Equity:				
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>
Non-current liabilities:				
12% loan stock	3,500	-	-	-
Deferred tax liability	2,660	2,200	370	-
Current liabilities:				
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.

Samaki Group		
Statement of comprehensive income for the year ended 31 December 2015		
	Sh. "million"	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"
Assets:		
Non-current assets:		
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>
Current assets:		
Inventories	2,400	1,914
Trade receivables	1,830	1,446
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>
Capital and liabilities:		
Capital and reserves:		
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
Long-term liabilities:		
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:

1. 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.

2. 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.

3. 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>

4. 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.
5. 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"

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

Current assets:	Sh. "000"
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>
Equity and liabilities:	
Equity:	
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
Non-current liabilities:	
10% debentures	4,000
Current liabilities:	
Bank overdraft	775.8
Accounts payable	1,962
Current income tax	<u>275.1</u>
Total equity and liabilities	<u>13,591</u>

Additional information:

- 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.
- 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.
- 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.
- 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.
- The current liabilities of Hasara Ltd. were taken over by Zawadi Ltd. at book value.
- The assets of Hasara Ltd. were taken over by Zawadi Ltd. at their fair values as follows:

	Sh. "000"
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

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

Required:

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

QUESTION FOUR

- With reference to IAS 36 (Impairment of Assets), discuss the treatment of impairment losses. (6 marks)
- 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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