



CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

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"
Assets:		
Non-current assets:		
Land and buildings		3,160
Plant and machinery		4,040
Intangible assets:		
Goodwill		1,300
Development expenditure		750
Current assets:		
Inventories	1,900	
Receivables	<u>1,700</u>	<u>3,600</u>
Total assets		<u>12,850</u>
Equity and liabilities:		
Equity:		
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"
Current liabilities:		
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:

1. The existing ordinary shares are to be written down to Sh.4 per share and then consolidated into shares of Sh.10 par.
2. 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.
3. 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.
4. 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.
5. The balances in the accumulated losses and goodwill accounts are to be written off.
6. Development expenditure is to be written off.
7. 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

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

Required:

- (i) Journal entries to record the above transactions. (6 marks)
- (ii) Capital reduction account. (4 marks)
- (iii) 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>(670,500)</u>	<u>(36,000)</u>	<u>(18,000)</u>
Gross profit	22,000	12,000	12,000
Distribution expenses	(2,500)	(1,200)	(1,000)
Administrative expenses	(5,500)	(2,400)	(2,000)
Finance cost	<u>(100)</u>	<u>-</u>	<u>-</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>	<u>-</u>	<u>-</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"
Assets:			
Non-current assets:			
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"
Current assets:			
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
Equity and liabilities:			
Equity:			
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>
Non-current liabilities:			
6% loan notes	3,000	-	-
Deferred tax	1,600	1,200	350
	<u>4,600</u>	<u>1,200</u>	<u>350</u>
Current liabilities:			
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.250 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)