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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 20 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

- (a) Bidii Cement Company is listed in the local securities market. Some of the other listed cement manufacturing companies provide extensive disclosures in their external reports about their environmental policies and practices.

Required:

- (i) Discuss two reasons that may cause Bidii Cement Company to voluntarily disclose its environmental policies and practices as part of its annual reports. (4 marks)
- (ii) Explain three potential advantages of voluntary environmental disclosures to Bidii Cement Company. (6 marks)
- (b) Milele Ltd. is a public limited company. As at 31 March 2019, Milele Ltd. had issued share capital of Sh.10 million. The shares are denominated at Sh.0.25 each. Milele Ltd.'s earnings attributable to its ordinary shareholders for the year ended 31 March 2019 were also Sh.10 million giving an earning per share of Sh.0.25.

The following transactions took place during the year ended 31 March 2020:

1. On 1 July 2019, Milele Ltd. issued eight million ordinary shares at full market value.
2. On 1 January 2020, a bonus issue of one ordinary share for every four ordinary shares held was made.
3. Earnings attributable to ordinary shareholders for the year ended 31 March 2020 were Sh.13,800,000.

Transactions for the year ended 31 March 2021 were as follows:

1. On 1 October 2020, Milele Ltd. made a rights issue of share of two new ordinary shares at a price of Sh.1.00 each for every five ordinary shares held. The offer was fully subscribed.
2. The market price of Milele Ltd. ordinary shares immediately prior to the offer was Sh.2.40.
3. Earning attributable to ordinary shareholders for the year ended 31 March 2021 were Sh.19,500,000.

Required:

- (i) Earning per share (EPS) for the year ended 31 March 2020 including comparative figure for the year ended 31 March 2019. (4 marks)
- (ii) Earning per share (EPS) for the year ended 31 March 2021 including comparative figure for the year ended 31 March 2020. (6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Operating segment information in a set of financial statements has been viewed by some investors as just too much information which may be difficult to understand. Some investors argue that this information is also costly to produce and its cost outweighs its benefits.

Required:

- (i) Describe three benefits that could be derived by investors from reviewing the operating segment disclosures accompanying financial statements when making decisions on investments. (6 marks)
- (ii) Explain two limitations of using operating segment information when making investment decisions. (4 marks)

- (b) Drible Cable (DC) experienced a period of rapid expansion in the six months following the launch of a new product on 1 July 2020. The following information is available from the books of DC:

	6 months to 31 December 2020 Sh. "000"	6 months to 30 June 2020 Sh. "000"
Inventories at period end	1,220	460
Receivables at period end	1,715	790
Cash and cash equivalents at period end	-	150
Trade payables at period end	1,190	580
Short-term borrowings at period end	250	-
Revenue for the period	3,100	2,000
Cost of sales for the period	2,420	1,450

Note:

Assume a 365-day year.

Required:

For each of the periods above, calculate the following ratios:

- (i) Inventories turnover period. (1 mark)
- (ii) Payables turnover period. (1 mark)
- (iii) Receivables turnover period. (1 mark)
- (iv) Current ratio. (1 mark)
- (v) Quick ratio. (1 mark)
- (vi) Gross profit margin. (1 mark)
- (vii) Using the calculations in (b) (i) to (vi) above, comment on the financial performance of DC. (4 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Duka Limited owns a piece of machinery and entered into an agreement to lease the machinery on 1 January 2017. In the lease contract, the company requires four annual payment of Sh.28,679 starting on 1 January 2017. The present value of the lease payments using a 10% discount rate is Sh.100,000 and the fair value of the equipment is Sh.90,000. The useful life of the machinery is four years and its salvage value is zero.

Required:

- (i) Duka Ltd.'s cumulative income related to the lease. (8 marks)
- (ii) Distinguish between reporting a lease as an operating lease or as a finance lease in the financial statements. (4 marks)
- (iii) Jane Mara, a financial analyst is seeking to identify companies with potential unrecorded leases. She studied the 2020 annual report of Basket Ltd. which reported an operating lease from 2020 to 2025 as shown below:

Basket Ltd.	
Operating lease payments	
Year	Amount Sh. "000"
2020	215
2021	186
2022	160
2023	141
2024	136
2025	136

Jane Mara noted that Basket Ltd. had issued a bond with an effective interest rate of 6% per annum.

Required:

The present value of the operating lease commitment.

(4 marks)

(b) The following information relates to Minoh Ltd.'s pension plan as at 31 December 2020:

1. The present value of a company's defined benefit obligation is Sh.5,485 million and the fair value of the pension plan asset is Sh.5,798 million.
2. The company has unrecognised transition liabilities of Sh.50 million, unrecognised actuarial losses of Sh.59 million and unrecognised past service costs of Sh.70 million.
3. The present value of available future refunds and reductions in future contribution is Sh.313 million.

Required:

The amount of the pension asset to be reported as at 31 December 2020 in the statement of financial position.

(4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) International Accounting Standard (IAS) 10, Events After the Reporting Period, shall be applied in the accounting for, and disclosure of, events after the reporting period.

Required:

(i) Explain the term "events after the reporting period". (2 marks)

(ii) Highlight two types of events that are identified under the standard. (2 marks)

(b) White Ltd. (WL) has a number of investments in subsidiary and associate entities. During the year ended 30 June 2020, WL acquired an investment in QB Ltd.

The statements of financial position of WL group for the years ended 30 June 2020 and 30 June 2019 are shown below:

	2020 Sh. "000"	2019 Sh. "000"
Assets:		
Non-current assets:		
Property, plant and equipment	25,500	22,200
Goodwill	6,800	6,000
Investment in associate	<u>6,200</u>	<u>5,700</u>
	38,500	33,900
Current assets	<u>42,500</u>	<u>42,950</u>
Total assets	<u>81,000</u>	<u>76,850</u>
Equity and liabilities:		
Equity attributable to owners of the parent company's share capital (par value Sh.1)	18,000	15,000
Share premium	4,200	-
Revaluation reserve	1,000	-
Retained earnings	<u>10,550</u>	<u>10,050</u>
	33,750	25,050
Non controlling interests	<u>9,750</u>	<u>9,100</u>
Total equity	43,500	34,150
Non-current liabilities:		
Long-term borrowings	20,550	26,200
Current liabilities	<u>16,950</u>	<u>16,500</u>
Total liabilities	<u>37,500</u>	<u>42,700</u>
Total equity and liabilities	<u>81,000</u>	<u>76,850</u>

Additional information:

1. During the year ended 30 June 2020, there was no disposal of property, plant and equipment. Depreciation charged for the year ended 30 June 2020 was Sh.1,200,000.
2. WL's share of the associate's profit for the year ended 30 June 2020 was Sh.1,800,000.
3. The total comprehensive income attributable to non-controlling interest for the year ended 30 June 2020 was Sh.350,000.
4. WL acquired 75% of the equity share capital of QB on 1 January 2020 for a cash consideration of Sh.300,000 and the issue of 1,000,000 ordinary shares of Sh.1 each in WL. WL's shares had a deemed value of Sh.2.15 per share at the date of acquisition.

5. The fair value of the net assets of QB acquired on 1 January 2020 were as follows:

	Sh. "000"
Property, plant and equipment	1,200
Inventories	1,700
Receivables	900
Cash and cash equivalents	200
Payables	<u>(1,800)</u>
Fair value of net assets	<u>2,200</u>

6. WL did not acquire or dispose of any other investments in the year. The group policy is to value non controlling interest at acquisition at its proportionate share of the fair value of the net assets acquired.
7. In the year ended 30 June 2020, QB paid a dividend but WL did not pay any dividend.

Required:

Extracts from the consolidated statement of cash flows for WL for:

- (i) Cash flows from investing activities for the year ended 30 June 2020. (8 marks)
- (ii) Cash flows from financing activities for the year ended 30 June 2020. (8 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) On 1 January 2020, Berry Ltd. acquired 90% of the outstanding shares of Cherry Ltd. in exchange for shares of Berry Ltd. with a fair value of Sh.180 million. The fair market value of Cherry Ltd.'s ordinary shares on the date of the exchange was Sh.200 million.

The following is a summary of the financial information of the two companies as at 31 December 2019:

	Berry Ltd.	Cherry Ltd.	
	Book value Sh. "000"	Book value Sh. "000"	Fair value Sh. "000"
Cash and receivables	40,000	15,000	15,000
Inventory	125,000	80,000	80,000
Property, plant and equipment	<u>235,000</u>	<u>95,000</u>	<u>155,000</u>
	<u>400,000</u>	<u>190,000</u>	<u>250,000</u>
Payables	55,000	20,000	20,000
Long-term debt	<u>120,000</u>	<u>70,000</u>	<u>70,000</u>
	<u>175,000</u>	<u>90,000</u>	<u>90,000</u>
Net assets	<u>225,000</u>	<u>100,000</u>	<u>160,000</u>
Shareholders equity:			
Ordinary shares	87,000	34,000	
Retained earnings	<u>138,000</u>	<u>66,000</u>	
	<u>225,000</u>	<u>100,000</u>	

Required:

- (i) The value of goodwill and the value of the non controlling interest on 1 January 2020 under the partial goodwill method. (3 marks)
- (ii) Consolidated statement of financial position as at 1 January 2020. (7 marks)
- (b) RTZ Ltd. operates in country N and has established the NSh as its functional currency. RTZ Ltd. acquired a piece of machinery from an international supplier on 20 November 2020. The invoice remained unpaid at the year ended 31 December 2020:

Relevant exchange rates (where NSh/KSh 2.00 means Nsh 1 = Ksh.2.00) are:

20 November 2020	Nsh/Ksh2.00
31 December 2020	Nsh/Ksh2.15

Required:

In accordance with International Accounting Standard (IAS) 21, The Effect of Changes in Foreign Exchange Rates:

- (i) Distinguish between “functional currency” and “presentation currency”. (4 marks)
 - (ii) Highlight two factors that RTZ Ltd. might have considered when establishing Nsh. as its functional currency. (2 marks)
 - (iii) Calculate the amounts to be included in the financial statements of RTZ Ltd. for the year ended 31 December 2020 in respect to the above transaction. (4 marks)
- (Total: 20 marks)**
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Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8065	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	.5739	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	.5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	.3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	.1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	.0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	.1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	.0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0318	.0221	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001		
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001				
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001						

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIFA_{r,n} = \sum_{t=1}^n \frac{1}{(1+r)^t} = \frac{1 - \frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1242
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9999	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250