

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"
Non-current assets:		
Intangible assets: Development costs		85,000
		Goodwill 60,000
Tangible assets: Buildings		270,000
		<u>Plant and machinery 326,000</u>
		741,000
Current assets:		
Inventories	426,000	
Trade receivables	<u>531,000</u>	957,000
Current liabilities:		
Trade payables	393,000	
Bank loans and overdrafts	<u>687,000</u>	<u>(1,080,000)</u>
Net assets		<u>618,000</u>
Equity:		
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
Expenses:		
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>

Mwingu Group
Statement of financial position as at 31 October:

	2015	2014
	Sh. "million"	Sh. "million"
Non-current assets:		
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
Current assets:		
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>
Total assets	<u>10,296</u>	<u>7,984</u>
Capital and liabilities:		
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
Non-Current liabilities:		
Debentures	1,360	400
Current liabilities:		
Trade payables	1,616	1,392
Accrued expenses	200	200
Bank overdraft	680	784
Taxation	<u>960</u>	<u>880</u>
Total capital and liabilities	<u>10,296</u>	<u>7,984</u>

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	31 October 2014
	Sh. "million"	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, Mwingu 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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