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CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 30 November 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) Highlight four limitations of financial reporting in the context of reporting on the social and environmental impacts of corporate activity. (4 marks)

(b) With regard to International Public Sector Accounting Standard (IPSAS) 4 (The Effects of Changes in Foreign Exchange Rates), explain the accounting treatment of exchange differences arising on translation of both monetary and non-monetary items in the financial statements of a public sector entity. (4 marks)

(c) On 1 January 2015, G Limited granted each of its 200 employees 500 share options. These share options were to vest if the employees still worked for the entity as at 31 December 2017 and if the share price on that date exceeded Sh.45.

On the grant date, the fair value of each option was Sh.15.

The share price on 31 December 2015 was Sh. 27 and it was considered unlikely that the share price would rise above Sh. 45 by 31 December 2017.

Twenty employees left the company during the year ended 31 December 2015 and a further twenty were expected to leave in each of the two years ended 31 December 2016 and 31 December 2017.

During the years ended 31 December 2016 and 31 December 2017, 15 employees and 25 employees left the company respectively.

Required:
Extracts from the financial statements of G Limited for each of the years ended 31 December 2015, 2016 and 2017 to record the above transactions. (6 marks)

(d) International Financial Reporting Standard (IFRS) 9 (Financial Instruments), sets out the hedge accounting rules which can only be applied if the criteria for the hedging relationship are met.

Required:
Citing relevant examples, describe the hedge effectiveness requirements. (6 marks)
(Total: 20 marks)

QUESTION TWO

B Limited and H Limited are private liability limited companies operating in the service sector. They have been reporting successive trading losses for several years, principally due to severe competition which has put downward pressure on their revenues.

The directors of the two entities, who are also the main shareholders, have unanimously agreed to wind up the companies' respective businesses and amalgamate them into a new company to be named S Limited with effect from 1 October 2018.

The statements of financial position of the two companies as at 30 September 2018 are as set out below:

	B Limited	H Limited
Assets:		
Non-current assets:	**Sh. "000"**	**Sh. "000"**
Property, plant and equipment	16,500	12,000
Intangible assets (copyrights)	8,400	-
	24,900	12,000
Current assets	52,500	30,000
Total assets	77,400	42,000

	Sh. "000"	Sh. "000"
Equity and liabilities:		
Equity:		
Ordinary share capital (Sh.10 par value)	30,000	16,000
7.5% cumulative preference share capital (Sh.10 par value)	10,000	24,000
Share premium	1,600	1,400
Retained profits (losses)	(23,400)	(34,300)
	18,200	7,100
Non-current liabilities:		
10% bonds	20,000	15,000
Current liabilities:		
Trade payables	37,200	18,400
Bank overdraft	2,000	1,500
Total equity and liabilities	77,400	42,000

Additional information:

1. The authorised share capital of the new company was Sh.120 million comprising 12 million ordinary shares of Sh.10 par value.
2. Preference dividends in B Limited were three years in arrears while in H Limited, preference dividends had not been paid for two years including the current year to 30 September 2018. Only 20% of the arrears of preference dividends were settled by issue of ordinary shares of Sh.10 each in S Limited.
3. S Limited issued 3.4 million ordinary shares of Sh.10 each credited at Sh.5 each in favour of the preference shareholders in both companies. The ordinary shares were allotted on the basis of the preference shares held in the old companies. The preference shareholders committed to immediately pay the balance on the shares issued.
4. The bondholders in both companies were settled immediately by the new company issuing ordinary shares of Sh.10 each to satisfy the nominal value of the bonds.
5. The new company also issued 4.6 million ordinary shares of Sh.10 each credited at Sh.2.50 each in favour of the ordinary shareholders in the old companies. The ordinary shares were allotted on the basis of the ordinary shares held in the old companies. The ordinary shareholders were to pay the balance on their shares immediately.
6. The current liabilities of the old companies were transferred to the new company at their book values.
7. The copyrights in B Limited expired upon amalgamation of the old companies and were therefore to be written off.
8. The tangible assets were taken over by S Limited at their fair values as follows:

	B Limited Sh. "000"	H Limited Sh. "000"
Property, plant and equipment	12,500	9,500
Current assets	58,000	38,600

9. Liquidation expenses of B Limited and H Limited amounting to Sh.8 million and Sh.5 million respectively were paid for by S Limited and treated as preliminary expenses.
10. Assume that all the above transactions were completed by the close of business on 30 September 2018.

Required:

(a) The following ledger accounts, in columnar form, to close off the books of B Limited and H Limited:

(i) Realisation account. (4 marks)

(ii) Preference shareholders sundry members account. (4 marks)

(iii) Ordinary shareholders sundry members account. (4 marks)

(b) Journal entries in the books of S Limited to record the transfer of assets and liabilities (Ignore narrations). (4 marks)

(c) Opening statement of financial position of S Limited as at 1 October 2018. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) In the context of the IFRS for Small and Medium-sized Entities (SMEs), identify any four areas where the SMEs standard differs from the IFRSs and IASs adopted by public limited entities. (4 marks)

(b) Below are the statements of financial position of Acacia Ltd., Baobab Ltd. and Cider Ltd. as at 30 June 2018.

	Acacia Ltd. Sh."million"	Baobab Ltd. Sh."million"	Cider Ltd. Sh."million"
Assets:			
Non-current assets:			
Property, plant and equipment	6,000	5,150	2,775
Investments	3,050	200	-
	9,050	5,350	2,775
Current assets:			
Inventories	1,520	645	600
Accounts receivable	735	300	315
Current account - Cider Ltd.	-	105	-
Cash and bank balance	178	450	375
	2,433	1,500	1,290
Total assets	11,483	6,850	4,065
Equity and liabilities:			
Equity:			
Ordinary shares of Sh.1 each	7,550	3,000	1,500
Share premium	67	200	168
Retained profit	1,200	1,650	987
	8,817	4,850	2,655
Non-current liabilities:			
8% debentures	975	1,020	900
Current liabilities:			
Accounts payable	1,050	690	420
Current tax	500	200	-
Dividend payable	141	90	-
Current account - Baobab Ltd.	-	-	90
	1,691	980	510
	11,483	6,850	4,065

Additional information:

1. Acacia Ltd. acquired 40% of the ordinary shares of Baobab Ltd. on 1 July 2016 at a cost of Sh.1,500 million when the retained profit and share premium of Baobab Ltd. were Sh.810 million and Sh.200 million respectively.

   On 1 January 2018, Acacia Ltd. acquired another 20% of the ordinary shares of Baobab Ltd. for a cash consideration of Sh.1,050 million. On that date, the fair value of the initial 40% ordinary shares of Baobab Ltd. was Sh.1,800 million.
2. On 1 January 2018, the carrying amount of the net assets of Baobab Ltd. reflected their fair value with the exception of an item of plant. The market value of the item of plant had decreased and the valuation report indicated a reduction of Sh.150 million. The plant had a remaining useful life of three years as at that date. Baobab Ltd. had not adjusted its books to reflect the new value.
3. Acacia Ltd. acquired 60% of the ordinary shares of Cider Ltd. on 1 July 2017 when the retained profit and share premium of Cider Ltd. were Sh.432 million and Sh.168 million respectively. The cost of this transaction was to be discharged by an issue of 600 million ordinary shares of Acacia Ltd. The fair value of the ordinary shares of Acacia Ltd. on 1 July 2017 was Sh.2.5 per share while that of Cider Ltd. was Sh.3.5 per share. This share exchange has not yet been recorded by Acacia Ltd. On 1 July 2017, the carrying amount of the identifiable net assets of Cider Ltd. reflected their fair values.
4. A quarter of the inventory of Cider Ltd. was purchased from Baobab Ltd. on 1 June 2018. The inventory had been invoiced at a mark-up of 25%.
5. On 1 June 2018, Acacia Ltd. disposed of a property to Baobab Ltd. at Sh.200 million above its carrying amount. The remaining useful life of this property was 10 years.
6. At the end of June 2018, Cider Ltd. had declared a final dividend of 3%. These dividends had not been provided for.
7. Acacia Ltd. has not yet recorded its share of the ordinary dividend from Baobab Ltd.
8. The difference in the current accounts is due to cash in transit.
9. Profits and losses of Baobab Ltd. were deemed to accrue evenly from 1 July 2016 until 30 June 2018.
10. Acacia Ltd. retained all its investments at cost.
11. The depreciation policy of the group is to depreciate all its property, plant and equipment on a straight line basis making a full year's charge in the year of purchase.
12. The group values the non-controlling interest at their proportionate share of the fair value of the net assets of the subsidiaries as at the acquisition date.

Required:

Consolidated statement of financial position of the Acacia group as at 30 June 2018. (16 marks)

(Total: 20 marks)

QUESTION FOUR

The following draft consolidated financial statements relate to the Bakoki Ltd. group:

Consolidated statement of income for the year ended 31 July 2018:

	Sh."million"	Sh."million"
Revenue		5,845
Cost of sales		(2,160)
Gross profit		3,685
Distribution costs	510	
Administrative expenses	230	(740)
		2,945
Income from interests in associated company		990
Operating profit		3,935
Profit on disposal of tangible assets		300
Income from investments		80
Interest payable		(300)
Profit before tax		4,015
Income tax		(1,345)
Profit after tax		2,670
Non-controlling interest (equity)		(200)
Profit attributable to members of group		2,470
Dividend paid		(800)
Retained profit for the year		1,670

Consolidated statement of financial position as at 31 July:

	2018 Sh."million"	2017 Sh."million"
Assets:		
Non-current assets:		
Tangible assets	7,750	5,000
Intangible assets	200	-
Investment in associated company	2,200	2,000
Other investments	820	820
	10,970	7,820
Current assets:		
Inventories	3,930	2,000
Trade receivables	3,700	2,550
Cash and bank balances	9,030	3,640
	16,660	8,190
Total assets	27,630	16,010
Equity and liabilities:		
Equity:		
Share capital	7,880	4,000
Share premium	5,766	4,190
Retained earnings	6,270	4,600
	19,916	12,790
Non-controlling interest	230	-
	20,146	12,790
Non-current liabilities	4,400	1,366
Current liabilities	3,084	1,854
Total equity and liabilities	27,630	16,010

Additional information:

1. Bakoki Ltd. has two wholly owned subsidiaries. In addition, it acquired a 75% interest in Nyange Ltd. on 1 August 2017. It also holds a 40% interest in Birika Ltd. which it acquired several years ago. Goodwill has not become impaired.
2. The following are the fair values of Nyange Ltd. at the date of acquisition of its shares:

Nyange Ltd.
Statement of financial position as at 1 August 2017

	Sh."million"	Sh."million"
Plant and machinery		330
Current assets:		
Inventories	64	
Trade receivables	56	
Cash and bank balance	224	344
Current liabilities (including corporation tax of Sh.34 million)		(170)
		504

	Sh."million"	Sh."million"
Share capital		100
Retained earnings		404
		504

3. The consideration for the purchase of the shares of Nyange Ltd. comprised 44 million ordinary shares of Sh.10 of Bakoki Ltd. at a value of Sh.550 million and a further payment of Sh.28 million being made in cash.
4. The tax charge in the consolidated income statement is made up of the following items:

	Sh."million"
Corporation tax	782
Deferred tax	208
Tax attributable to associated company	355
	1,345

5. The tangible non-current assets of Bakoki Ltd. group comprised the following:

	Building Sh."million"	Plant and Machinery Sh."million"	Total Sh."million"
Cost or valuation:			
As at 1 August 2017	5,100	2,800	7,900
Additions	-	4,200	4,200
Disposals	-	(1,000)	(1,000)
	5,100	6,000	11,100
Depreciation:			
As at 1 August 2017	700	2,200	2,900
Charge for the year	250	400	650
Disposal	-	(200)	(200)
	950	2,400	3,350
Carrying amount as at 31 July 2018	4,150	3,600	7,750

6. Included in the additions to plant and machinery are items totalling Sh.1,700 million acquired under finance leases. The plant and machinery disposed of during the year resulted in a profit of Sh.300 million. All lease rentals were paid on their due dates.
7. Non-current liabilities comprise the following:

	2018 Sh."million"	2017 Sh."million"
Obligations under finance leases	1,417	1,340
6% debentures	2,923	-
Deferred tax	60	26
	4,400	1,366

8. There had been an issue of debentures on 1 August 2017. The par value was Sh.3,000 million but they were issued at a discount of Sh.100 million. The effective rate of interest was 7%.
9. Current liabilities comprised the following items:

	2018 Sh."million"	2017 Sh."million"
Trade payables	1,600	960
Obligations under finance leases	480	400
Corporation tax	924	434
Accrued interest	80	60
	3,084	1,854

Required:
Consolidated statement of cash flows for the Bakoki Ltd. group for the year ended 31 July 2018, in accordance with the requirements of International Accounting Standard (IAS) 7 "Statement of Cash Flows".

(Total: 20 marks)

QUESTION FIVE

(a) Citing four reasons, explain the usefulness of related party disclosures when analysing the financial position and financial performance of a business organisation. (4 marks)

(b) Discuss the significance of the earnings per share (EPS) figure in the analysis of the performance of companies. (4 marks)

(c) IAS 33 (Earnings Per Share) sets out the requirements for calculating and disclosing the basic earnings per share figure for quoted entities.

The following figures appeared in the consolidated income statement and other comprehensive income of Uwezo Ltd. for the year ended 31 July 2018 together with comparatives for the year ended 31 July 2017:

	2018 Sh."million"	2017 Sh."million"
Profit before tax	400	300
Income tax	(75)	(60)
Profit after tax	325	240
Other comprehensive income		
(Revaluation gain on land)	30	10
Total comprehensive income	355	250
Profit after tax for the year attributable to:		
Owners of the group	280	210
Non-controlling interest	45	30
	325	240
Total comprehensive income for the year attributable to:		
Owners of the group	310	220
Non-controlling interest	45	30
	355	250

The statement of financial position extract as at 31 July 2018 together with comparatives for the year ended 31 July 2017 were as follows:

	2018 Sh."million"	2017 Sh."million"
Equity share capital (Sh.0.5 each)	460	200
4% preference share capital	100	100
Share premium	215	60
Other equity reserves	90	60
Non-controlling interest	85	40
Retained earnings	688	570
Total equity	1,638	1,030

During the year ended 31 July 2018, the following changes took place in relation to the issued share capital of Uwezo Ltd.:

1. 100 million equity shares were issued in relation to the acquisition of another business. These shares were issued at full market price on 1 November 2017.
2. 150 million ordinary shares were issued for cash to existing shareholders on 1 February 2018. The issue price was Sh.1.5 per share which represents a discount of 25% on the traded price of Sh.2.0 per share immediately before the issue.
3. On 30 June 2018, a bonus issue was completed by capitalising Sh.135 million of retained earnings.
4. On 31 July 2018, the preference dividend for the year and an equity dividend of Sh.23 million were paid.

Required:

(i) The basic earnings per share (EPS) for the years ended 31 July 2017 and 31 July 2018. (10 marks)

(ii) The comparative EPS for 2017 to be reported in the 2018 financial statements. The EPS figure reported in 2017 was Sh.0.525. (2 marks)

(Total: 20 marks)

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