KASNEB

CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 26 May 2017. **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

The following is the summary of financial statements relating to A Ltd., B Ltd., C Ltd. and D Ltd. for the financial year ended 31 March 2017:

Income statements for the year ended 31 March 2017:

	A Ltd. Sh."million"	B Ltd. Sh."million"	C Ltd. Sh."million"	D Ltd. Sh."million"
Revenue	1,200	850	600	800
Cost of sales	(650)	(450)	(320)	(410)
Gross profit	550	400	280	390
Other incomes	50	29.5	-	-
	600	429.5	280	390
Distribution costs	(120)	(70)	(90)	(100)
Administrative expenses	(180)	(80)	(120)	(120)
Finance cost	(20)	(10)	(30)	(20)
Profit before tax	280	269.5	40	150
Income tax expense	(60)	(80)	(12)	(50)
Profit for the period	220	189.5	28	100
Dividends paid	(80)	(60)	(10)	(50)
Retained profit for the year	140	129.5	18	50
Retained profit brought forward	450	300	218	260
Retained profit carried forward	590	429.5	236	310

Statement of financial position as at 31 March 2017:

Assets:	A Ltd. Sh."million"	B Ltd. Sh."million"	C Ltd. Sh."million"	D Ltd. Sh."million"
Non-current assets:				
Property, plant and equipment	1,400	800	1,200	1,100
Intangible assets	250	180	200	120
Investment in B Ltd.	800			
Investment in C Ltd.		600		
Investment in D Ltd.		400		
Available for sale financial assets	50	30		
	2,500	2,010	1,400	1,220
Current assets:				
Inventory	100	80	90	70
Trade and other receivables	160	140	150	120
Bank and cash balances	40	60	30	50
	300	280	270	240
Total assets	2,800	2,290	1,670	1,460
Capital and liabilities:				
Ordinary share capital (Sh.10 par value)	1,000	500	400	500
Share premium	400	300	250	300
Available for sale reserve	10	5		
Retained profits	590	429.5	236	310
	2,000	1,234.5	886	1,110

	A Ltd. Sh."million"	B Ltd. Sh."million"	C Ltd. Sh."million"	D Ltd. Sh."million"
Non-current liabilities:				
10% loan stock	200	100	300	200
Deferred tax	40	30	20	30
	240	130	320	230
Current liabilities:				
Trade and other payables	280	425.5	260	100
Bank loans	200	400	150	-
Current tax	80	100	54	20
	560	925.5	464	120
Total capital and liabilities	2,800	2,290	1,670	1,460

Additional information:

1. A Ltd. acquired 80% of the share capital in B Ltd. on 1 April 2014 when the retained profits of B Ltd. were Sh.100 million. An item of plant in B Ltd. had a fair value of Sh.20 million above its carrying amount and depreciation is at 20% per annum. There were no other reserves other than the share premium.
2. B Ltd. acquired 75% of the share capital in C Ltd. on 1 April 2015 when the retained profits of C Ltd. were Sh.100 million. Land belonging to C Ltd. had a fair value of Sh.50 million above its carrying amount.
3. B Ltd. also acquired 40% shares of D Ltd. on 1 April 2015 when the retained profits of D Ltd. were Sh.150 million.
4. The group uses the partial goodwill method and even though no impairment was reported in previous years, half of the goodwill has been reported impaired in the current year for B Ltd. and C Ltd. The goodwill of D Ltd. was not impaired.
5. Intercompany sales were as follows during the year:

Seller	Buyer	Selling price Sh."million"	Margin %	Balance in stock
C Ltd.	B Ltd.	200	50	50%
B Ltd.	A Ltd.	250	40	25%
B Ltd.	D Ltd.	100	40	-

6. Inter-company balances were as follows:

	Sh."million"
Due from B Ltd. to C Ltd.	40
Due from A Ltd. to B Ltd.	50
Due from D Ltd. to B Ltd.	20

Required:

(a) Consolidated income statement for the year ended 31 March 2017. (10 marks)

(b) Consolidated statement of financial position as at 31 March 2017. (10 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain the accounting treatment of embedded derivatives under IFRS 9 (Financial Instruments). (4 marks)

(b) Distinguish between a "fair value hedge" and a "cash flow hedge" citing the accounting treatment of each. (6 marks)

(c) On 1 January 2014, Comair Ltd. issued 500 share options to each of its 1,000 employees eligible for the employee share ownership scheme.

The fair value of each option at the date of grant was Sh.30. The options had a vesting period of three years, and any employee who resigned before 31 December 2016 was not entitled to any shares.

As at 1 January 2014, the management estimated that 5% of the employees would exit during the year. On 1 January 2015, the estimated number of employees who would exit was revised to 8%.

Actual information from the company's human resources department indicated that 24 employees exited during the year to 31 December 2014, 17 employees exited during the year to 31 December 2015 and 6 employees exited during the year to 31 December 2016.

Required:

(i) Journal entries to record the transactions with regard to the share options for each of the years ended 31 December 2014, 31 December 2015 and 31 December 2016. (8 marks)

(ii) Explain how your answer in (c) (i) above would be different if the employees had the option to be paid the cash equivalent to the market price of the shares vested. (2 marks)

(Total: 20 marks)

QUESTION THREE

Juhudi Ltd. is an electronics company which has been listed on the securities exchange for the last two years. Provided below are the equity and long-term funds of the company as at 30 April 2016.

Also provided are the income statements and statements of movements in reserves for the years ended 30 April 2016 and 30 April 2017 respectively.

Equity and long-term funds as at 30 April 2016:

	Sh. "000"
Ordinary share capital (Sh.8 par value)	19,200
Share premium	4,800
6% preference share capital	500
Retained profit	3,240
Total equity	27,740
Long term funds:	
8% convertible loan stock	1,000
Total equity and non-current liabilities	28,740

Income statement for the year ended 30 April:

	2017 Sh. "000"	2016 Sh. "000"
Revenue	25,100	21,720
Cost of sales	(20,080)	(16,290)
Gross profit	5,020	5,430
Operating expenses	(1,220)	(1,200)
Profit before interest and tax	3,800	4,230
Interest on loan stock	(80)	(80)
Profit before tax	3,720	4,150
Taxation	(535)	(520)
Profit for the year	3,185	3,630

Statement of movements in reserves as at:

	30 April 2017 Sh. "000"	30 April 2016 Sh. "000"
Retained profit brought forward	3,240	-
Profit for the year	3,185	3,630
Preference dividend	(30)	(30)
Ordinary dividend	(480)	(360)
Retained profit carried forward	5,915	3,240

Additional information:

1. On 1 November 2016, the company made a bonus issue of shares on the basis of one ordinary share for every six ordinary shares held.
2. On 1 March 2017, the company made a rights issue of one ordinary share for every seven ordinary shares held. The rights issue price was Sh.8.5 per share. The market value of one ordinary share on the date of the rights issue was Sh.12.5 per share.
3. The 8% convertible loan stock can be converted at the option of the holders from the year 2022 at the rate of 125 ordinary shares for every Sh.1,000 of the loan stock held.
4. The corporation tax rate is 30%.
5. There was no issue of preference share capital in the year 2017.
6. There was no issue of loan stock in the year 2017.

Required:

(a) The basic earnings per share (EPS) for the year ended 30 April 2016. (2 marks)

(b) The basic earnings per share (EPS) for the year ended 30 April 2017. (8 marks)

(c) The adjusted earnings per share (EPS) for the year 2016 that would be shown in the year 2017 as a comparative for the EPS. (4 marks)

(d) The diluted earnings per share. (6 marks)

(Total: 20 marks)

QUESTION FOUR

(a) The management commentary (management discussion and analysis) provides users with integrated information that provides a context for the related financial statements.

Required:

Discuss three contents of a management commentary in an entity's financial statements. (6 marks)

(b) Munro Ltd., a manufacturing company, provides for deferred income tax in accordance with IAS 12 (Income Taxes). The following is an extract from the statement of financial position as at 30 April 2017:

Assets:	**Sh."000"**
Non-current assets:	
Property, plant and equipment	14,000
Intangible assets	4,000
Goodwill	6,000
Financial assets – available for sale	12,000
Current assets:	
Inventories	7,500
Trade receivables	6,650
Prepayments	3,200
Cash and cash equivalents	1,250
	54,600
Equity and liabilities:	
Equity:	
Share capital	12,000
Revaluation reserves	3,000
Retained profit	12,260
Non-current liabilities:	
Interest-bearing loans	16,000
Deferred income tax (1 May 2016)	1,200
Current liabilities:	
Trade and other payables	8,000
Employee benefits	2,000
Current income tax	140
	54,600

Additional information:

1. The tax bases of the assets are as follows:

	Sh."000"
Property, plant and equipment	2,800
Prepayments	1,500
Interest-bearing loans	17,000
Financial assets (available for sale)	14,000

2. Inventories are stated at fair value less cost to sell which is lower than the original cost due to a general provision for price decline of Sh.3.5 million.
3. The intangible assets comprise development cost which is tax deductible when the amount is paid out. The cost of intangible assets was paid in the year 2014 and is presented net of armotisation cost.
4. Goodwill and employee benefits are tax exempt.
5. Trade and other payables include provision for leave allowance of Sh.1.4 million which is tax deductible on cash basis.
6. Trade receivables are stated net of general allowances for bad debts at the rate of 5% of the gross receivables. The general allowance is not tax deductible until it becomes specific.

7. The building, which is included in property, plant and equipment was revalued during the year. The increase in value of Sh.3 million does not affect the tax base.
8. The tax base of other items is equal to their carrying amount.
9. The tax rate applicable is 30%.

Required:

(i) Deferred tax balance as at 30 April 2017. (12 marks)

(ii) Deferred income tax account as at 30 April 2017. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Summarise three main reasons for developing a conceptual framework for the preparation and presentation of financial statements. (6 marks)

(b) (i) In the context of International Public Sector Accounting Standard (IPSAS) 18 "Segment Reporting", differentiate between a "service segment" and a "geographical segment". (4 marks)

(ii) IPSAS 25 "Employee Benefits" prescribes the accounting and disclosure requirements by public sector entities for employee benefits.

Required:

Explain three types of employee benefits with a brief description of the accounting treatment of each. (6 marks)

(c) To maintain or create a good corporate image to the society within which a company operates, there is need to take responsibility for any actual or potential social impact caused by the company's activities. This should be reported through a social responsibility report.

Required:

Comparing conventional financial reporting with social responsibility reporting, explain two practical challenges peculiar to social responsibility reporting. (4 marks)

(Total: 20 marks)

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