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CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

FRIDAY: 1 December 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

(a) Explain three benefits of integrated reporting to both an organisation and the users of financial statements. (6 marks)

(b) The following statements of comprehensive income relate to W Ltd. and its investee companies S Ltd. and F Ltd. for the year ended 31 March 2017:

Statements of comprehensive income:

	W Ltd. Sh."million"	S Ltd. Sh."million"	F Ltd. Sh."million"
Revenue	976	420	63
Cost of sales	(687)	(228)	(26.2)
Gross profit	289	192	36.8
Other income	6.1	-	-
Dividend received	8.1	-	-
Operating expenses	(68)	(54)	(13.4)
Finance cost	(12)	(18)	(6.2)
Profit before tax	223.2	120	17.2
Income tax expense	(45)	(30)	(3.2)
Profit after tax for the year	178.2	90	14
Other comprehensive income:			
Gain on revaluation of property	15	12	2
Total comprehensive income for the year	193.2	102	16
Retained earnings (1 April 2016)	2,350	625	145
Equity share capital (1 April 2016)	1,000	775	10

Additional information:

1. W Ltd. bought 60% holding in the equity shares of S Ltd. on 1 April 2016. The purchase consideration was agreed at Sh.900 million of which Sh.600 million was paid in cash. The balance was satisfied by immediate issue of a 5% bond at par. S Ltd.'s net assets had a fair value of Sh.1,400 million as at 1 April 2016 represented by equity share capital of Sh.775 million and retained earnings of Sh.625 million. It was decided to apply the proportion of net assets method to calculate goodwill on acquisition. No impairment loss on goodwill arose during the year ended 31 March 2017.
2. W Ltd. sold its entire 60% equity holding in S Ltd. on 31 March 2017 for Sh.1,150 million in cash. No entry had been made to reflect this transaction.
3. W Ltd. owned 90% of the equity shares of F Ltd. since incorporation. No goodwill arose on this acquisition. There were no retained earnings in existence as at the acquisition date.
4. During the year ended 31 March 2017, W Ltd. sold goods to F Ltd. for Sh.15 million. These goods were sold by W Ltd. at a mark-up of 50% on cost. Three fifth (3/5) of these goods remained in the inventory of F Ltd. as at 31 March 2017. An amount of Sh.4.3 million remained outstanding to W Ltd. in respect of these goods as at 31 March 2017.
5. On 1 March 2017, F Ltd. declared an interim dividend of Sh.9 million. W Ltd. has recorded its share of this dividend as income. No other dividends were declared by the group companies during the year ended 31 March 2017.
6. All expenses and gains are assumed to accrue evenly throughout the year. No new equity capital was issued by any group company during the year ended 31 March 2017.
7. Interest on the 5% bond was payable in arrears. No payment had been made or provided for.

Required:

(i) The gain (or loss) on disposal of the shares in S Ltd. on 31 March 2017. (4 marks)

(ii) Consolidated statement of comprehensive income for the year ended 31 March 2017. (10 marks)

(Total: 20 marks)

QUESTION TWO

(a) With reference to International Public Sector Accounting Standard (IPSAS) 21 "Impairment of Non-Cash-Generating Assets", explain three matters in respect of which an entity should disclose each material impairment loss recognised or reversed during the reporting period. (6 marks)

(b) On 1 January 2014, R Ltd. promised to pay its 200 employees a bonus in cash that would be based on how the company's share performed on the securities exchange. The bonus was to be paid on 31 December 2016 as long as the market price of the company's share was Sh.55 and above and the employee was still working for the company. As at 1 January 2014, the market price of the share was Sh.50 and the par value of one share was Sh.10. The bonus was to be the equivalent of 100 shares.

The following information in relation to the three years was availed:

Year ended	Number of employees leaving	Market price of a share (Sh.)
31 December 2014	10	55
31 December 2015	15	58
31 December 2016	15	60

All the employees who were in employment as at 31 December 2016 were paid the bonus.

Required:

Show how the bonus would be accounted for and reported over the three-year period ended 31 December 2016. (6 marks)

(c) The following information was extracted from the books of Comfort Retirement Benefit Scheme for the years ended 31 October 2016 and 31 October 2017:

	2016	2017
Discount rate on 1 November	10%	8%
Expected rate of return on plan assets – 1 November	12%	10%
Average remaining service life (years)	10	10

	2016 Sh. "million"	2017 Sh. "million"
Fair value of plan assets – 1 November	96	110
Present value of plan obligations – 1 November	100	125
Current service cost	8	10
Benefits paid	15	12
Contributions to the scheme	9	11
Past service cost	4	-

Additional information:

1. As at 1 November 2015, the present value of plan obligations and the fair value of plan assets were both Sh.100 million.
2. Assume all transactions occurred at the year end.

Required:

For each of the years ended 31 October 2016 and 31 October 2017, determine:

(i) The actuarial gains or losses. (2 marks)

(ii) The net pension cost to be charged in the income statement for each of the two years. (4 marks)

(iii) Balances to be reflected in the statement of financial position as at the end of each year. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Citing three reasons, explain the rationale behind the inclusion of an environmental report in a reporting entity's annual report. (6 marks)

(b) The following are the group statement of comprehensive income and the group statement of financial position of Maneno Group of Companies for the financial years ended 31 October 2016 and 31 October 2017:

Maneno Group
Statement of comprehensive income for the year ended 31 October 2017

	Sh. "million"	Sh. "million"
Revenue		3,075
Cost of sales		(1,470)
		1,605
Gain on sale of subsidiary		120
Share of profit after tax in associate		144
		1,869
Expenses:		
Distribution costs	240	
Administrative expenses	480	
Finance cost	450	1,170
Profit before tax		699
Income tax expense		(144)
Profit after tax for the year		555
Gain on revaluation of land		60
Total comprehensive income for the year		615
Attributable to: Parent	540	
Non-controlling interest	75	615

Maneno Group
Statement of financial position as at 31 October:

	2017		2016	
	Sh. "million"	Sh. "million"	Sh. "million"	Sh. "million"
Assets:				
Non-current assets:				
Property, plant and equipment		18,000		13,500
Goodwill		255		390
Investment in associate		510		420
		18,765		14,310
Current assets:				
Inventory	3,900		3,090	
Trade receivables	3,120		3,120	
Financial assets at fair value	135		30	
Cash and bank balances	510	7,665	390	6,630
Total assets		26,430		20,940
Equity and liabilities:				
Ordinary share capital		6,000		4,500
Share premium		900		-
Revaluation reserve		150		-
Retained profit		10,200		9,960
Shareholders' funds attributable to parent		17,250		14,460
Shareholders' funds attributable to non-controlling interest		225		525
		17,475		14,985
Non-current liabilities:				
Bank loans	4,200		3,000	
Obligations under finance lease	630		135	
Deferred tax	1,020	5,850	915	4,050
Current liabilities:				
Trade payables	2,955		1,785	
Accrued interest	21		27	
Current tax	84		63	
Obligations under finance lease	45	3,105	30	1,905
Total equity and liabilities		26,430		20,940

Additional information:

1. During the year ended 31 October 2017, depreciation of Sh.240 million was charged in relation to property, plant and equipment.
2. An item of property with a carrying value of Sh.885 million was disposed of during the year ended 31 October 2017 for Sh.750 million in cash. The loss on disposal is part of the cost of sales.

3. On 1 August 2017, the group disposed of an 80% owned subsidiary for Sh.1,170 million in cash. The subsidiary had the following net assets as at the date of disposal:

	Sh. "million"
Property, plant and equipment	2,025
Inventory	90
Trade receivables	135
Cash and bank balances	105
Trade payables	(540)
Current tax	(15)
Bank loans	(600)
	1,200

The subsidiary had been acquired on 1 November 2012 for a cash payment of Sh.660 million when its net assets had a fair value of Sh.675 million and the non-controlling interest had a fair value of Sh.150 million.

4. Additional property, plant and equipment was acquired by way of lease amounting to Sh.900 million during the year ended 31 October 2017.
5. Dividends paid by the holding company during the year ended 31 October 2017 amounted to Sh.120 million.
6. Land was revalued upwards by the holding company by Sh.60 million during the year ended 31 October 2017.

Required:

The group statement of cash flows in accordance with International Accounting Standard (IAS) 7 "Statement of Cash Flows" for the year ended 31 October 2017. (14 marks)

(Total: 20 marks)

QUESTION FOUR

(a) International Financial Reporting Standard (IFRS) 3 "Fair Value Measurement" establishes a fair value hierarchy that categorises into three levels the inputs to the valuation techniques used to measure fair value.

Required:

Explain the three levels referred to above. (6 marks)

(b) The following information relates to SugarServe Ltd. for the year ended 31 May 2016:

1. The net profit of the company for the period attributable to preference shareholders and ordinary shareholders of the company was Sh.14.6 million.

2. Information on ordinary shares was as follows:

	"million"
• Ordinary shares of Sh.10 each in issue as at 1 June 2015	6
• Ordinary shares issued on 1 September 2015 at full price	1.2

The average market price of the shares for the year ended 31 May 2016 was Sh.100 and the closing price of the shares as at 31 May 2016 was Sh.110. On 1 January 2016, 300,000 partly paid ordinary shares of Sh.10 each were issued. They were issued at Sh.80 per share with Sh.40 payable on 1 January 2016 and Sh.40 payable on 1 January 2017. Dividend participation was 50% until fully paid.

3. Convertible loan stock of Sh.20 million at an interest rate of 5% per annum was issued at par on 1 April 2015. Half year's interest was payable on 30 September and 31 March each year. Each Sh.1,000 of the loan stock was convertible at the holder's option into 300 ordinary shares at any time. Sh.5 million of the loan stock was converted into ordinary shares on 1 April 2016 when the market price of the shares was Sh.100 per share.
4. Sh.1 million of convertible preference shares of Sh.10 each were issued in the year ended 31 May 2012. Dividends were to be paid half yearly on 30 November and 31 May at the rate of 6% per annum. The preference shares were convertible into ordinary shares at the option of the preference shareholders on the basis of two ordinary shares for each preference share issued. Holders of Sh.600,000 preference shares converted them into ordinary shares on 1 December 2015.
5. Corporate tax rate was 30%.

Required:

(i) Basic earnings per share (EPS) for the year ended 31 May 2016. (6 marks)

(ii) Diluted EPS for the year ended 31 May 2016. (8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Highlight six examples of unethical behaviour by the management of business entities which professional accountants should report about. (6 marks)

(b) (i) With reference to International Financial Reporting Standard (IFRS) 8 "Operating Segments", outline four disclosure requirements for a reportable segment. (4 marks)

(ii) The following information was obtained from the financial records of Super Food Group for the year ended 31 October 2017:

Consolidated income statement for the year ended 31 October 2017:

	Sh. "000"
Sale of goods	237,489
Service revenue	17,131
Rental income	1,404
Revenue	256,024
Cost of sales	(163,816)
Gross profit	92,208
Other income	1,585
Selling and distribution costs	(14,775)
Administrative expenses	(64,055)
Other expenses	(1,088)
Operating profit	13,875
Finance revenue	785
Finance cost	(1,627)
Share of associate's profit	83
Profit before tax	13,116
Tax expense	(3,775)
Profit after tax for the year	9,341

Consolidated statement of financial position as at 31 October 2017:

	Sh. "000"	Sh. "000"
Assets:		
Non-current assets:		
Property, plant and equipment		33,919
Investment properties		10,803
Intangible assets		6,195
Investment in associate		764
Available for sale investments		10,082
Deferred tax assets		383
		62,146
Current assets:		
Inventories	33,875	
Trade and other receivables	39,873	
Derivative financial instruments	153	
Cash and short-term deposits	22,628	96,529
Total assets		158,675
Equity and liabilities:		
Issued share capital		52,375
Retained earnings		39,190
		91,565
Non-current liabilities:		
Interest bearing loans and borrowings		15,078
Convertible preference shares		2,778
Employee benefit liabilities		7,644
Deferred tax liability		3,103
Current liabilities:		
Trade and other payables	17,841	
Interest bearing loans and borrowings	2,460	
Income tax payable	3,980	
Provisions	599	
Other liabilities	13,627	38,507
Total equity and liabilities		158,675

Additional information:

1. For management purposes, the business is organised into five operating segments: retail, catering, manufacturing, publishing and others.
2. Details of the operating segments are provided below:

(a) **Revenues**

	Total revenue Sh. "000"	Inter-segment revenue Sh. "000"
Retail	129,842	-
Catering	66,853	7,465
Manufacturing	39,495	36,791
Publishing	32,306	-
Others	37,447	5,663

(b) **Operating profit**

	Sh. "000"
Retail	6,887
Catering	4,716
Manufacturing	1,283
Publishing	1,169
Others	3,284

(c) **Segment assets and liabilities**

	Assets Sh. "000"	Liabilities Sh. "000"
Retail	50,152	14,839
Catering	45,145	9,783
Manufacturing	24,620	3,609
Publishing	14,165	4,704
Others	23,829	34,175
Investment in associate	764	

3. Inter-segment profit amounted to Sh.4,223,000.

Required:

Segment report, as far as the information provided above allows, according to International Financial Reporting Standard (IFRS) 8 "Operating Segments". (10 marks)

(Total: 20 marks)

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