KASNEB

CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

PILOT PAPER

September 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

Khan Ltd. operates in the media sector. The company has invested in two other companies. The draft statements of financial position as at 30 April 2015 for Khan Ltd. and its investee companies Choby Ltd. and Ghax Ltd. were as presented below:

	Khan Ltd. Sh."million"	Choby Ltd. Sh."million"	Ghax Ltd. Sh."million"
Assets			
Non-current assets			
Property, plant and equipment	6,590	4,000	2,400
Investments in: Choby Ltd.	3,350		
Ghax Ltd.	1,400		
	11,340	4,000	2,400
Current assets	1,970	1,722	300
	13,310	5,722	2,700
Equity and liabilities			
Ordinary share capital	1,700	2,040	1,200
Retained earnings	6,680	1,960	700
Other reserves	500	160	80
	8,880	4,160	1,980
Non-current liabilities	3,790	1,350	400
Current liabilities	640	212	320
	13,310	5,722	2,700

Additional information:

1. Khan Ltd. acquired 30% of Choby Ltd. on 1 May 2012 for a cash consideration of Sh.1,200 million when the fair value of Choby Ltd.'s identifiable assets was Sh.3,680 million. Khan Ltd. treated the investment as an associate up to 1 May 2014 when its share of post acquisition profits in Choby stood at Sh.180 million and its share of post acquisition revaluation reserve was Sh.20 million. On this date Khan Ltd. acquired a further 40% of the ordinary shares of Choby Ltd. for a cash consideration of Sh.1,950 million thereby acquiring control.
2. On 1 May 2014, the fair value of Choby Ltd.'s identifiable net assets was Sh.4,500. The fair value of the interest in Choby Ltd. held by Khan Ltd. before the combination was Sh.1,410 million and the fair value of the 30% non controlling interest was assessed at Sh.1,240 million. Retained earnings of Choby Ltd. on 1 May 2014 and its other reserves were Sh.1,800 million and Sh.140 million respectively. Non controlling interest is measured at fair value in group financial statements.
3. On the date of the business combination with Choby Ltd., Khan Ltd. included in the fair value of Choby Ltd. an unrecognised contingent liability in respect of a legal claim against Choby Ltd. in the amount of Sh.12 million. The amount was revised on 1 August 2014 to Sh.10 million. The amount has met the criteria for recognition as a provision under current liabilities and the revision estimate is deemed to be a measurement period adjustment.
4. In addition, buildings with a carrying amount of Sh.400 million and had been included in the fair value of Ghoby Ltd. on 1 May 2014. The buildings had a remaining useful life of 20 years on that date and Khan Ltd. had commissioned an independent valuation which was subsequently received on 1 September 2014 resulting in a decrease of Sh.80 million in the property, plant and equipment of Choby Ltd. on acquisition date. This decrease did not affect the fair value of the non controlling interest and has not been reflected in the financial statements. The excess of fair value of net assets over the carrying value on 1 May 2014 is due to an increase in the value of non depreciable land and the contingent liability.
5. On 1 May 2014, Khan Ltd. acquired 80% of the equity interest of Ghax Ltd. paying Sh.1,400 million in cash. The fair value of net identifiable assets was Sh.1,920 million and the fair value of non controlling interest on this date was Sh.500 million. The retained earnings and other reserves of Ghax Ltd. on acquisition date were Sh.600 million and Sh.80 million respectively. The excess in fair value is due to an unrecognised franchise right which Khan Ltd. granted to Ghax Ltd. on 1 May 2013 for 5 years. On the date of acquisition, the franchise could be sold at market value.

6. On 30 April 2014, Khan Ltd. carried a property in its financial statements at its revalued amount of Sh.28 million. Depreciation is charged at Sh.600,000 per annum on a straight line basis. In August 2014, the management decided to sell the asset and it was advertised for sale and by 31 August 2014 the sale was considered highly probable and the criteria for non-current assets held for sale was met. On this date, fair value of the asset was Sh.30.8 million and its value in use was Sh.31.6 million. Costs to sell the asset were estimated at Sh.600,000. On 30 April 2015, the asset was sold for Sh.31.2 million. No entries have been made as the cash proceeds on the sale were not received until 31 May 2015. This transaction is deemed material.

Required:
Consolidated statement of financial position for Khan group as at 30 April 2015. (20 marks)

QUESTION TWO
Cindy Ltd.'s trial balance as at 30 June 2015 was as follows:

		Sh. "000"	Sh. "000"
Revenue			320,250
Cost of sales		205,200	
Distribution costs		26,250	
Administrative expenses		28,500	
Interest on loan note		2,250	
Investment income			600
Ordinary shares Sh.0.50 each			90,000
6% loan note			37,500
Retained earnings 1 July 2014			6,450
Land and buildings (land Sh.15 million)		75,000	
Plant and equipment at cost		125,550	
Accumulated depreciation 1 July 2014:	- Buildings		12,000
	- Plant and equipment		50,550
Financial asset carried at fair value		25,500	
Inventory		37,200	
Trade receivables		42,750	
Bank		4,350	
Current tax		1,650	
Deferred tax			1,800
Trade payables			55,050
		574,200	574,200

Additional information:

1. On 1 July 2014, Cindy Ltd. sold one of its products for Sh.15 million (included in revenue) and committed to provide ongoing service and maintenance for three years from the date of transaction. The estimated servicing cost is Sh.900,000 per annum and Cindy Ltd.'s gross profit margin on this type of servicing is 25%. Ignore discounting.
2. Cindy Ltd. issued a Sh.37.5 million 6% loan on 1 July 2014. Issue costs were Sh.3 million included in administrative expenses. Interest is paid annually on 30 June each year. The loan will be redeemed on 30 June 2017 at a premium which gives an effective interest rate of 8%.
3. Cindy Ltd. has been carrying land and buildings at depreciated cost using the cost model. However, due to a recent rise in prices the company decided to revalue its property on 1 July 2014. A professional valuer confirmed the value of property at Sh.90 million (land element Sh.18 million) on that date. Property had a remaining useful life of 16 years and deferred tax on the revaluation is to be adjusted in the income statement from the profits for the year.
4. On 1 July 2014, Cindy Ltd. had a processing plant installed at a cost of Sh.15 million included in the cost of plant in the trial balance. The process the plant performs will cause immediate contamination of nearby land. Cindy Ltd. will have to clean up this land at the end of the plant's ten year life. The present value of the clean up discounted at 10% per annum was Sh.9 million on 1 July 2014 and the company has not recorded this cost. This plant is depreciated at 10% per annum on straight line basis.
   All other plant and equipment are depreciated at 12.5% per annum on a reducing balance basis. All depreciation is charged to the cost of sales and amounts for the current year have not been charged.
5. The fair value of investments was Sh.23.55 million on 30 June 2015.
6. The balance on current tax represents under/overprovision of tax liability for the year ended 30 June 2014. Current tax provision for the year ended 30 June 2015 is estimated at Sh.11.1 million. Cindy Ltd. had taxable temporary differences amounting to Sh.7.5 million on 30 June 2015.
7. Corporate tax rate was 30%.

Required:
In a format and classification suitable for publication:

(a) Statement of comprehensive income for the year ended 30 June 2015. (12 marks)

(b) Statement of financial position as at 30 June 2015. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) Galvin Ltd. purchased a zero coupon bond for Sh.600,000 redeemable in five years on 1 January 2014. The effective interest rate is 10% and the bond is carried at amortised cost.

Required:

(i) Valuation of the bond to be reflected in the statement of financial position as at 31 December 2015. (3 marks)

(ii) Finance income for the year ending 31 December 2015. (3 marks)

(b) Sophistic Ltd., a newly listed company has provided the following information with regards to computation of its tax expense for the year ended 31 May 2014:

	Sh. "000"
Accounting profit	42,900
Depreciation	6,000
Donations	1,000
Amortisation of software	2,400
	52,300
Capital allowances	(7,500)
	44,800
Tax expense - at 25%	11,200

The company has not yet determined tax expense for the year ended 31 May 2015.

Additional information:

1. Accounting profit for the year ended 31 May 2015 was Sh.55,200,000 while donations amounted to Sh.600,000.
2. An extract of non-current assets movement schedule for the year ended 31 May 2015 was as follows:

	Plant	Software
Cost 1 June 2014	32,000	9,000
Additions during the year	-	-
Accumulated depreciation 1 June 2014	19,200	5,400
Tax written down value 1 June 2014	18,500	?

3. Plant is depreciated at 20% per annum using the straight line method while wear and tear allowance on plant is provided at 25% on a reducing balance basis.
4. Software development commenced in the year ended 31 May 2011 and was completed in the immediate subsequent year. The company capitalised development costs which amounted to Sh.9,000,000 and amortisation commenced on 1 June 2012 using the sum of digits method over the estimated useful life of 5 years. Software development costs are allowed in full for tax purposes in the year in which they are incurred.
5. Donations made by the company were not tax allowable.
6. Corporate tax rate applicable on the company's earnings for the year ended 31 March 2015 is 30% and the company is expected to continue generating taxable profits in the foreseeable future.

Required:

(i) Current tax to be charged in the income statement for the year ended 31 May 2015. (4 marks)

(ii) Deferred tax liability to be reflected in the statement of financial position as at 31 May 2014. (4 marks)

(iii) Deferred tax liability account for the year ended 31 May 2015. (6 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Volta Ltd. operates a defined retirement benefit plan for its employees. On 1 January 2014, the fair value of the pension plan assets was Sh.2,600,000 and the present value plan liabilities were Sh.2,900,000.

The actuary estimated current and past service costs for the year ended 31 December 2014 at Sh.450,000 and Sh.90,000 respectively. The past service cost is caused by an improvement in pension benefits commencing 31 December 2014.

The pension plan paid Sh.240,000 on 31 December 2014 and on the same date Volta Ltd. paid Sh.730,000 in contributions to the plan.

Interest rate on high quality corporate bonds for the year was 8%.

As at the year end fair value of pension plan assets was Sh.3,400,000 and present value plan liabilities were Sh.3,500,000.

In accordance with year 2011 revision to IAS 19 Employee Benefits, Volta Ltd. recognises measurement gains and losses in other comprehensive income in the period they occur.

Required:
Calculate the measurement gains or losses on pension plan assets and liabilities that will be included in other comprehensive incomes for the year ended 31 December 2014. (6 marks)

(b) Ozen Ltd. is a manufacturing company quoted on the securities exchange. The following information was extracted from the records of the company:

1. On 1 January 2013, the company had an issued and outstanding share capital of 300,000 ordinary shares of Sh.20 each and 100,000 8% convertible preference shares of Sh.50 each. All ordinary shares were fully paid and the preference shares were convertible into ordinary shares at the rate of 3 ordinary shares for every two preference shares fully paid.
2. The company reported profits after tax of Sh.1,200,000 in the year ended 31 December 2013 and Sh.1,800,000 in the year ended 31 December 2014. The profit for the year ended 31 December 2014 is after inclusion of a profit of Sh.250,000 from operations discontinued in the period.
3. On 1 April 2013 the company made a rights issue of one fully paid ordinary share at Sh.60 for every 3 ordinary shares when the shares were trading at Sh.84. each.
4. On 1 October 2013 the company issued 200,000 ordinary shares at market price.
5. Due to the high market price of its shares Ozen Ltd. split its shares in the ratio of two fully paid ordinary shares of Sh.10 each for every one ordinary share of Sh.20 each on 1 April 2014.
6. The company offered 200,000 stock options on 1 June 2014 with an exercise price of Sh.30 when the average market price per share was Sh.40 in the year. None of the options were exercised.
7. On 1 July 2014 the company issued 8% convertible debentures amounting to Sh.4 million. The debentures were convertible into ordinary shares at the rate of 60 fully paid ordinary shares for every Sh.1,000 of the debentures. None of the debentures were converted in the year ended 31 December 2014.
8. The company had issued 6% debentures with a nominal value of Sh.5 million in the year 2010. The debentures were convertible into ordinary shares at the rate of 60 fully paid ordinary shares for every Sh.1,000 of the debentures. None of the debentures had been converted by 31 December 2013. However, on 1 October 2014 holders of Sh.3 million debentures converted them to ordinary shares.
9. Corporate tax rate was 30%.

Required:

(i) Basic EPS for each of the years ended 31 December 2013 and 2014. (8 marks)

(ii) Diluted EPS for the year ended 31 December 2014. (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) In line with IPSAS 23 - Revenue from Non Exchange transactions:

(i) Distinguish between exchange transactions and non exchange transactions. (4 marks)

(ii) Enumerate four examples of non exchange transactions. (4 marks)

(b) Explain the contents of the following reports:

(i) Environmental report. (6 marks)

(ii) Directors report. (6 marks)

(Total: 20 marks)

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