kasneb

CPA PART III SECTION 6

ADVANCED FINANCIAL REPORTING

THURSDAY: 28 November 2019. **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) International Financial Reporting Standards (IFRSs) are developed by the International Accounting Standards Board (IASB) through a formal system of due process and broad international consultation involving accountants, financial analysts, financial statements users and regulatory bodies from around the world.

The overall agenda of the IASB will initially be set by discussion with the IFRS Advisory Council.

Required:
Explain the steps that are followed in the process of setting International Financial Reporting Standards. (4 marks)

(b) Many countries have adopted international financial reporting standards (IFRSs) issued by the International Accounting Standards Board (IASB). However, due to local requirements and other challenges, some countries still prefer to use their own local standards.

Required:
(i) Summarise five reasons why reporting entities would prefer to adopt IFRSs. (5 marks)

(ii) Identify five challenges that reporting entities are likely to encounter while implementing IFRSs. (5 marks)

(c) Integrated reporting (IR) is a concept that urges reporting entities to focus on the value creators within their business with a focus on the longer-term success of a business rather than the short-term focus on results.

Required:
Explain three objectives of integrated reporting (IR). (6 marks)
(Total: 20 marks)

QUESTION TWO

(a) International Accounting Standard (IAS) 21: "The Effects of Changes in Foreign Exchange Rates" requires the transactions carried out by an entity in foreign currencies and the financial statements of a foreign operation (foreign subsidiary) to be translated into the presentation currency of the reporting entity.

Required:
In the context of the International Accounting Standard (IAS) 21, explain the treatment of exchange differences (gains/losses) arising on translation, clearly distinguishing the treatment in the individual entity's financial statements and in the consolidated financial statements. (6 marks)

(b) H Limited, a public limited company whose functional currency is the Kenya Shilling (Ksh.), operates in the mining sector and has recently acquired a foreign subsidiary, B Limited. The functional currency of B Limited is the Krone (Kr.).

The following draft statements of financial position relate to the two entities as at 30 September 2019:

	H Limited Ksh."million"	B Limited Kr."million"
Assets:		
Non-current assets:		
Property, plant and equipment	7,007	7,826
Investment in B Limited	838	-
	7,845	7,826

	H Limited Ksh."million"	B Limited Kr."million"
Current assets:		
Inventories	1,566	2,605
Trade receivables	1,401	2,000
Cash and cash equivalents	1,238	1,399
	4,205	6,004
Total assets	12,050	13,830
Equity and liabilities:		
Equity:		
Ordinary share capital	2,875	3,640
Share premium	1,437	1,820
Retained earnings	3,350	3,640
Total equity	7,662	9,100
Non-current liabilities:		
10% loan note	450	1,310
Deferred tax	569	1,600
	1,019	2,910
Current liabilities:		
Trade payables	2,498	1,238
Current tax	871	582
	3,369	1,820
Total equity and liabilities	12,050	13,830

Additional information:

1. On 1 October 2018, H Limited acquired 80% of the ordinary shares of B Limited when B Limited's retained earnings were 3,100 million Krones.

   The fair value of the identifiable net assets of B Limited on 1 October 2018 was 9,008 million Krones. The excess of the fair value over the carrying amount of net assets is due to an increase in the value of land.

2. H Limited wishes to use the "full goodwill" method and the fair value of the non-controlling interest in B Limited as at 1 October 2018 was 4,550 million Krones. There has been no impairment of goodwill since acquisition.
3. On 1 October 2018, H Limited issued a 10% loan note amounting to Ksh. 40 million to B Limited repayable in ten years' time. Interest on the loan note has been correctly accounted for by both entities. However, the loan note is still recorded in the financial statements of B Limited at the amount obtained by applying the rate of exchange at the date of the issue.
4. H Limited expanded its overseas operations and on 1 April 2019, acquired an overseas building with a fair value of 715 million Krones. In exchange for the building, H Limited paid the seller with land which it had held for long term capital appreciation. The carrying amount of the land was Ksh.100 million but it had an open market value of Ksh.140 million. H Limited has only recorded the transfer of Ksh.100 million from investment properties to property, plant and equipment. The transaction has commercial substance. H Limited has a policy of depreciating buildings over a period of 35 years and follows the revaluation model. As a result of a surge in the market, it is estimated that the fair value of the overseas building was 800 million Krones as at 30 September 2019.
5. The following foreign exchange rates are relevant to the preparation of consolidated financial statements:

	Krones to Ksh.1
1 October 2018	6.0
1 April 2019	5.5
30 September 2019	5.0
Average for the year to 30 September 2019	5.8

Required:

Consolidated statement of financial position for the H group as at 30 September 2019 in accordance with International Financial Reporting Standards. Round your figures to the nearest Ksh."million". (14 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain two factors which encourage reporting entities to disclose social and environmental information. (4 marks)

(b) (i) On 1 January 2009, the government built a market at a cost of Sh.150 million. The market was expected to provide service for 40 years. On 31 December 2018 after ten years of use, a fire caused severe structural damage to the market. Due to safety concerns, the market was closed for repairs that cost Sh.106.5 million. These repairs were made to restore the market to occupiable condition. The current cost of a new market is Sh.300 million.

Required:
Impairment loss to be recognised for the market using the cost restoration approach. (4 marks)

(ii) On 1 January 2014, the government acquired a modern software to enhance service delivery at a cost of Sh.350 million. The software had an estimated useful life of 8 years and its benefits would accrue evenly on a straight line basis over the software's useful life. As at 31 December 2018, usage of the software had dropped to 15% of its originally anticipated demand. A software to replace the remaining service potential of the existing software would cost Sh.150 million.

Required:
Determine the impairment loss to be recognised for the software using the depreciated replacement cost approach. (4 marks)

(c) On 1 January 2014, Wale Ltd. granted its 500 employees options to buy 1,000 shares each from the company on condition that they continued working for the company until 31 December 2016.

During the year 2014, 35 employees left and it was estimated that a further 60 would leave in years 2015 and 2016.

During the year 2015, 40 employees left and it was estimated that a further 25 employees would leave in year 2016.

During the year 2016, 22 employees left.

As at 31 December 2016, 150 employees exercised their options. Another 140 employees exercised their options on 31 December 2017 and the remaining 113 exercised their options as at 31 December 2018.

The terms of the options were that the company would pay for the shares on behalf of the employees. The fair values of the shares were as follows:

31 December	Fair value per share (Sh)
2014	72
2015	77.5
2016	91
2017	107
2018	125

Required:
The amounts to be recognised in the income statement as an expense for each of the 5 years and the liability to be recognised in the statement of financial position as at 31 December for each year. (8 marks)

(Total: 20 marks)

QUESTION FOUR

The following financial statements relate to Makongeni Group for the year ended 31 October 2019:

Makongeni Group:
Consolidated statement of financial position as at 31 October:

	2019 Sh."million"	2018 Sh."million"
Assets:		
Non-current assets:		
Property, plant and equipment	10,180	6,500
Goodwill	7,720	7,400
Investment in associate	2,480	2,160
	20,380	16,060

	2019 Sh."million"	2018 Sh."million"
Current assets:		
Inventories	1,880	1,740
Trade receivables	1,560	1,320
Short-term investments	300	200
Cash and bank balances	540	360
	4,280	3,620
Total assets	24,660	19,680
Equity and liabilities:		
Equity:		
Ordinary share capital (Sh.10 par value)	6,000	6,000
Revaluation surplus	3,000	2,100
Retained earnings	7,020	4,340
	16,020	12,440
Non-controlling interest	1,240	1,280
Total equity	17,260	13,720
Non-current liabilities:		
Bank loans	2,000	1,200
Deferred tax	600	420
	2,600	1,620
Current liabilities:		
Trade payables	3,200	2,900
Current tax	1,600	1,440
	4,800	4,340
Total equity and liabilities	24,660	19,680

Makongeni Group:
Consolidated statement of comprehensive income for the year ended 31 October 2019

	Sh."million"
Revenue	8,360
Operating expenses	(4,620)
Profit from operations	3,740
Gain on disposal of subsidiary	400
Finance costs	(140)
Share of profit of associate	460
Profit before tax	4,460
Income tax expense	(900)
Profit after tax for the year	3,560
Other comprehensive income:	
Revaluation gain on property	800
Other comprehensive income of associate	200
Total comprehensive income	4,560
Profit for the year attributable to:	
Owners of the parent	3,180
Non-controlling interests	380
	3,560
Total comprehensive income for the year attributable to:	
Owners of the parent	4,080
Non-controlling interests	480
	4,560

Additional information:

1. During the year, Makongeni Limited acquired 80% of the ordinary share capital of Razak Limited, paying a cash consideration of Sh.6,000 million.

   The non-controlling interest holding was measured at its fair value of Sh.1,360 million at the date of acquisition.

The fair values of the net assets of Razak Limited as at the date of acquisition comprised the following:

	Sh."million"
Property, plant and equipment	5,120
Inventories	600
Trade receivables	960
Cash and cash equivalents	320
Trade payables	(880)
Tax payables	(160)
	5,960

2. During the year, Makongeni Limited also disposed of its entire 60% ordinary shareholding in Salama Limited. The subsidiary had been acquired several years ago for a cash consideration of Sh.2,400 million.

   The non-controlling interest holding was measured at its fair value of Sh.1,280 million as at the date of acquisition and the fair value of Salama Limited's net assets was Sh.2,920 million.

   Goodwill on acquisition of Salama Limited had not suffered any impairment.

   At the date of disposal, the net assets of Salama Limited had carrying values in the consolidated statement of financial position as set out below:

	Sh."million"
Property, plant and equipment	2,900
Inventories	660
Trade receivables	480
Cash and cash equivalents	200
Trade payables	(320)
	3,920

3. The short term investments are readily convertible into known amounts of cash and there is an insignificant risk of their fair value changing.
4. Depreciation of Sh.1,540 million was charged during the year. Plant with a carrying amount of Sh.1,000 million was sold for Sh.1,100 million. The gain on disposal was recognised in operating profit.

   Some properties were revalued during the year resulting in revaluation gain of Sh.800 million being reported.

   Ignore deferred tax on revaluation of property, plant and equipment.

Required:
Consolidated statement of cash flows for the Makongeni Group for the year ended 31 October 2019 using the indirect method in accordance with International Accounting Standard (IAS) 7 "Statement of Cash Flows". **(20 marks)**

QUESTION FIVE

(a) Dakika Ltd. has prepared its consolidated financial statements for the year to 30 September 2019, extracts of which are shown below. Also provided below are extracts of the consolidated financial statements for the year to 30 September 2018.

Year ended 30 September:	**2019** Sh."000"	**2018** Sh."000"
Profit before interest and tax	8,830	7,012
Finance cost	1,045	987
Tax charge	1,718	1,264
Ordinary dividends paid	120	100
Preference dividends paid	60	60
Profit attributable to non-controlling interest (NCI)	180	160

You have also obtained the following information in respect of the company's share capital:

1. Ordinary share capital as at 1 October 2017 was Sh.15,000,000 made up of shares of Sh.5 par value.
2. Dakika Ltd. issued some 500,000 ordinary shares at full market value on 1 January 2018.
3. Dakika Ltd. also made a rights issue of 2 new ordinary shares for every 10 ordinary shares held as at 1 April 2019. The rights price per share was Sh.42.5 (market value per share as at the same date was Sh.48).
4. Dakika Ltd. also had 1,000,000 6%, Sh.10 par value non-redeemable preference shares as at 1 October 2018.

Required:

(i) The basic earnings per share (EPS) for the year ended 30 September 2018. (4 marks)

(ii) The basic earnings per share (EPS) for the year ended 30 September 2019. (6 marks)

(b) Mafuta Limited had a deferred tax liability as at 1 October 2018 of Sh.400 million.

For the purposes of preparing the financial statements for the year ended 30 September 2019, the following additional information is available:

1. The company has available for sale financial assets with a carrying amount of Sh.80 million and financial assets at fair value through profit and loss of Sh.40 million. Both financial assets had reported losses in fair value of Sh.8 million each as at 30 September 2019.
2. Inventory is shown at the lower of cost and net realisable value. The cost is Sh.3,200 million while the net realisable value is Sh.3,120 million.
3. Receivables had a carrying amount of Sh.2,000 million after making an allowance for doubtful debts of Sh.80 million and an exchange gain of Sh.160 million (unrealised). Both the allowance and the exchange gain are not allowed for tax purposes.
4. Trade and other payables are stated at Sh.3,600 million after making provision for discount of Sh.40 million.
5. Property, plant and equipment has a carrying amount of Sh.4,800 million and a tax base of Sh 4,000 million. Some land and buildings were revalued upwards by Sh.200 million during the year ended 30 September 2019.
6. Intangible assets consisting of trade licences being amortised over five years had a carrying amount of Sh.240 million. This was allowed for tax purposes in full two years ago.
7. Assume a tax rate of 30%.

Required:

(i) The relevant temporary differences. (8 marks)

(ii) Journal entry to record changes in the deferred tax liability. (2 marks)

(Total: 20 marks)

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