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CPA ADVANCED LEVEL

ADVANCED FINANCIAL REPORTING AND ANALYSIS

MONDAY: 4 April 2022. Afternoon paper. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings. Do NOT write anything on this paper.

QUESTION ONE

P Limited is a public limited company listed in the securities exchange. It has diversified its activities by acquiring S Limited, a company domiciled in a foreign country.

Both companies prepare their financial statements in accordance with International Financial Reporting Standards. The presentation currency of the group is the Kenya Shilling (Ksh.) while S Limited's functional currency is the Franc (Fr.)

The draft financial statements for the year ended 31 December 2021 are as set out below:

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Statements of profit or loss for the year ended 31 December 2021:

	P Limited Ksh."million"	S Limited Fr."million"
Revenue	2,145	10,500
Cost of sales	(915)	(6,300)
Gross profit	1,230	4,200
Distribution costs	(150)	(750)
Administrative expenses	(345)	(1,350)
Operating profit	735	2,100
Investment income	15	-
Finance costs	(30)	(150)
Profit before tax	720	1,950
Income tax expense	(165)	(450)
Profit for the period	555	1,500

Statements of financial position as at 31 December 2021:

Assets:	P Limited Ksh."million"	S Limited Fr."million"
Non-current assets:		
Property, plant and equipment	4,850	7,000
Investment in S Limited	710	-
	5,560	7,000
Current assets:		
Inventory	1,030	2,400
Trade receivables	970	1,960
Cash and cash equivalents	410	540
	2,410	4,900
Total assets	7,970	11,900
Equity and liabilities:		
Equity:		
Ordinary share capital	1,500	1,000
Share premium	500	-
Retained earnings	2,560	3,100
Total equity	4,560	4,100

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Non-current liabilities:	Ksh."million"	Fr."million"
10% bond	820	2,640
Deferred tax	740	2,160
	1,560	4,800
Current liabilities:		
Trade payables	1,330	2,240
Current tax	520	760
	1,850	3,000
Total equity and liabilities	7,970	11,900

Additional information:

1. On 1 January 2021, P Limited acquired 80% of S Limited's 1,000 million Fr 1 ordinary shares for a cash consideration of Fr. 3,550 million.
2. As at the acquisition date, the carrying value of S Limited's net assets was Fr. 2,600 million, but the fair value was Fr.3,200 million. The excess in fair value over the carrying value was due to an unrecognised brand with a remaining useful economic life of five years as at the acquisition date.
3. The non-controlling interest in S Limited as at the acquisition date was valued at Fr. 1,450 million using the fair value method.
4. As at 31 December 2021, it was determined that goodwill arising on the acquisition of S Limited was impaired by 10%.
5. The following foreign exchange rates are relevant:

	Fr. to Ksh.1
1 January 2021	5
31 December 2021	4
Average for the year ended 31 December 2021	6

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Required:

(a) Determine the exchange differences (gains/losses) arising on the retranslation of net assets and goodwill on acquisition of the foreign subsidiary. (6 marks)

(b) Consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2021. (6 marks)

(c) Consolidated statement of financial position as at 31 December 2021. (8 marks)

(Total: 20 marks)

QUESTION TWO

The following draft group financial statements relate to H Limited, a public limited company, and its investment companies:

Group statement of financial position as at 31 October:

Assets:	**2021**	**2020**
Non-current assets:	**Sh."million"**	**Sh."million"**
Property, plant and equipment (PPE)	4,275	4,185
Goodwill	945	1,080
Other intangible assets	1,350	1,800
Investment in associate	720	810
Financial assets	1,935	1,620
	9,225	9,495
Current assets:		
Inventories	1,395	1,710
Trade receivables	1,125	1,620
Cash and cash equivalents	4,185	2,745
Total assets	15,930	15,570
Equity and liabilities:		
Equity:		
Ordinary share capital	8,000	6,000
Revaluation surpluses (PPE and financial assets)	300	200
Retained earnings	3,715	3,135
Equity attributable to group owners	12,015	9,335
Equity attributable to non-controlling interest	810	585
Total equity	12,825	9,920

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	Sh."million"	Sh."million"
Non-current liabilities:		
Long-term borrowings	235	610
Deferred tax	315	880
Current liabilities:		
Trade payables	2,115	2,920
Current tax	440	1,240
Total equity and liabilities	15,930	15,570

Group statement of profit or loss and other comprehensive income for the year ended 31 October 2021:

	Sh."million"
Revenue	11,140
Cost of sales	(8,870)
Gross profit	2,270
Distribution costs	(405)
Administrative expenses	(450)
Operating profit	1,415
Share of profit of associate	90
Operating profit and income from associate	1,505
Investment income (including dividend income)	270
Finance costs	(100)
Profit before tax	1,675
Income tax expense	(415)
Profit for the year	1,260
Other comprehensive income:	
Fair value gain on financial assets	35
Gain on revaluation of property	65
Total comprehensive income for the year	1,360

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Additional information:

1. During the year ended 31 October 2021, H Limited disposed of its entire 80% equity holding in S Limited for Sh.310 million in cash.

   The carrying amounts of the identifiable net assets of S Limited at the disposal date comprised:

	Sh. "million"
Property, plant and equipment	210
Inventories	90
Trade receivables	50
Cash and cash equivalents	30
Trade payables	(60)
Deferred tax liability	(20)
	300

   The gain/loss on disposal of the subsidiary is included in administrative expenses. The disposal of S Limited is not classified as a separate major line of business or geographical operation.

   The investment in S Limited had been acquired several years ago at a consideration of Sh.230 million when the fair values of the identifiable net assets stood at Sh.250 million.
2. The group policy is to measure the non-controlling interest in all subsidiaries at their proportionate share of net assets at the acquisition date.
3. An impairment test carried out at 31 October 2021 showed that goodwill other than that arising on the acquisition of S Limited was impaired. Other intangible assets were also impaired.
4. H Limited disposed of plant with a carrying amount of Sh.440 million for cash proceeds of Sh.560 million. The gain on disposal is included in administrative expenses.
   Depreciation charged to profit or loss during the year ended 31 October 2021 was Sh.260 million.

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5. The following schedule relates to the financial assets at fair value through other comprehensive income held by H Limited:

	Sh."million"
Balance as at 1 November 2020	1,620
Less carrying amount of financial assets disposed of	(235)
Add purchases of financial assets	515
Add fair value gain on financial assets	35
Balance as at 31 October 2021	1,935

The sale proceeds of financial assets were Sh.360 million. Profit on the sale of the financial assets is included in investment income in the financial statements.

6. The profit for the year attributable to the non-controlling interests amounted to Sh.390 million.

Required:
A consolidated statement of cash flows for H Group for the year ended 31 October 2021 using the indirect method in accordance with International Accounting Standard (IAS) 7 "Statement of Cash Flows". **(Total: 20 marks)**

QUESTION THREE

(a) With regard to International Financial Reporting Standard (IFRS) 15: "Revenue from Contracts with Customers", explain the key factors that must be considered when determining the transaction price within a contract. (4 marks)

(b) The following accounting information was extracted from the financial records of Kibo Limited regarding the defined retirement benefit scheme for its employees:

	Sh."million"
Net defined benefit obligation as at 1 January 2021	1,850
Net defined benefit obligation as at 31 December 2021	2,000
Current service cost	200
Contributions to scheme	225
Benefits paid by trustees	150

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The market yield on high quality corporate bonds is at the rate of 5%. Assume there are no tax implications regarding the retirement benefit obligation.

Required:
With suitable calculations, explain the accounting treatment of the various elements of the defined benefit scheme on the financial statements of Kibo Limited for the year ended 31 December 2021, in accordance with International Accounting Standard (IAS) 19 "Employee Benefits". (6 marks)

(c) R Limited, a publicly traded company, had 9 million ordinary shares of Sh.1 par value and 1 million, 7% redeemable preference shares of Sh.10 par value each on 1 October 2020.

As at that date, R Limited also had in issue 2.5 million stock options. These options are exercisable at Sh.1.5 per share. The average fair value per ordinary share during the year ended 30 September 2021 was Sh.2.

R Limited's profit for the year to 30 September 2021 from continuing operations was Sh.14,575,000 (30 September 2020: Sh.15,100,000).

The following transactions took place during the year ended 30 September 2021:

1. On 1 January 2021, the company issued 1.8 million ordinary shares in a 1 for 5 rights issue at a price of Sh.2 when the market price per share on cum-rights basis was Sh.5.
2. On 1 April 2021, R Limited issued 1 million ordinary shares at their full market value.
3. On 1 July 2021, the company issued a Sh.5 million convertible bond with an effective interest rate of 12%. The bond is convertible into ordinary shares at the holders' option on the basis of 60 shares per Sh.100 bond. None of the bond was converted during the year ended 30 September 2021.
4. The income tax rate applicable to R Limited is 30%.

Required:

(i) Basic earnings per share for the year ended 30 September 2021. (4 marks)

(ii) Restated earnings per share for the year ended 30 September 2020. (2 marks)

(iii) Diluted earnings per share for the year ended 30 September 2021. (4 marks)

(Total: 20 marks)

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QUESTION FOUR

The following information was extracted from the financial records of Belta Bank Limited as at 31 March 2022:

	Sh."million"
Cash and balances with the Central Bank	4,046
Money on demand and short term deposits	2,150
Deposits with other commercial banks	4,600
Deposits from other commercial banks	3,324
Investments in government securities	4,485
Investments in equity instruments	765
Property, plant and equipment	7,416
Intangible assets	4,986
Loans and advances to customers	8,144
Customer deposits	7,065
Long-term borrowings	5,660
Other receivables	2,493
Other payables	2,717
Instalment tax paid	360
Deferred tax as at 1 April 2021	370
Interest on loans and advances to customers	1,575
Interest on government securities	2,264
Interest on deposits with other banks	646
Interest on deposits from other banks	662
Interest on customer deposits	1,833
Interest on long term borrowings	1,385
Administrative expenses	2,160
Other operating expenses	1,163
Fees, commission and foreign exchange income	6,090
Ordinary share capital	4,400
Share premium	2,500
Deposit protection reserve as at 1 April 2021	5,000
Retained earnings as at 1 April 2021	3,623
Suspense account (Cr.)	414

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Additional information:

1. On 1 April 2021, Belta Bank Limited issued a Sh.450 million, five-year 8% coupon bond at par. The bond will be redeemable at a substantial premium which gives it an effective interest rate of 12% per annum. There were no issue costs. The only accounting entries made were to record the cash proceeds from the issue and the annual interest payment on 31 March 2022.
2. At 31 March 2022, the directors of Belta Bank Limited accepted a valuation report by a professional valuer which revealed the fair value of the property, plant and equipment to be Sh.2,500 million. The carrying amount of the property, plant and equipment amounted to Sh.1,850 million.
   The directors do not wish to make interreserve transfer upon revaluation. However, they do account for deferred tax on revaluation of property, plant and equipment. Revaluation is yet to be accounted for in the books of the bank.
3. During the year ended 31 March 2022, the current tax on profits was estimated at Sh.890 million. At 31 March 2022, the carrying amounts of the net assets exceeded their tax bases by Sh.1,800 million. These carrying amounts do not include the effect of the revaluation in note 2 above. The income tax rate applicable to Belta Bank Limited is 30%.

Required:

(a) Statement of profit or loss and other comprehensive income for the year ended 31 March 2022. (10 marks)

(b) Statement of financial position as at 31 March 2022. (10 marks)

(Total: 20 marks)

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QUESTION FIVE

(a) The objective of International Public Sector Accounting Standard (IPSAS) 20 "Related Party Disclosures" is to prescribe the disclosure requirements for related party relationships in public sector entities.

Required:
With reference to IPSAS 20 "Related Party Disclosures", briefly describe the related party disclosures required and indicate how they differ from the requirements of International Accounting Standard (IAS) 24 "Related Party Disclosures" for commercial sector entities. (4 marks)

(b) In the context of International Financial Reporting Standard (IFRS) 16 "Leases", outline the criteria for identifying a lease contract for the purpose of accounting in the financial statements of lessees. (4 marks)

(c) The International Accounting Standards Board (IASB) has issued a practice statement called "Making Materiality Judgements". This provides non-mandatory guidance that may help preparers of financial statements when applying IFRS standards.

Required:
In the light of the above statement, explain four contents of the practice statement "Making Materiality Judgements". (8 marks)

(d) Integrated Reporting (IR) is founded on integrated thinking that results in a periodic integrated report by an organisation about value creation over time and related communications regarding aspects of value creation.

Required:
In view of the above statement, evaluate the fundamental elements of Integrated Reporting (IR). (4 marks)

(Total: 20 marks)

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