CHARTERED ACCOUNTANTS EXAMINATIONS

PROFESSIONAL LEVEL

P1: ADVANCED FINANCIAL REPORTING

MONDAY 15TH DECEMBER 2014

TOTAL MARKS – 100: TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.

2. This paper is divided into TWO sections:

   Section A: Attempt this ONE (1) compulsory question.
   Section B: Attempt any THREE (3) questions.

3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

6. All workings must be done in the answer booklet.

7. Present legible and tidy work.

8. Graph paper (if required) is provided at the end of the answer booklet.

9. Present Value and Annuity tables are attached at the end of this question paper.

SECTION A

This question is compulsory and must be attempted

QUESTION ONE

The following consolidated financial statements relate to Satu Group for 2014.

Consolidated statement of profit or loss for the year ended 30th September 2014.

	K'million
Revenue	1,800
Cost of sales	(1,050)
Gross profit	750
Other income	250
Distribution costs	(225)
Administrative cost	(245)
Finance cost	(35)
Share of associate profit after tax	90
Profit before tax	585
Taxation	(85)
Profit for the period	500
Other comprehensive income	
Revaluation surplus	37
Net actuarial gain or loss	nil
Other comprehensive for the year	37
Total comprehensive income	537
Profit for the period attributable to:	
Equity shares of parent	418
Non – controlling interest	82
	500
Total comprehensive income attributable to:	
Equity shares of parent	455
Non – controlling interest	82
Total comprehensive income	537

Consolidated statements of financial position as at:

	30th September 2014 K'million	30th September 2013 K'million
Assets		
Non – current		
Property, plant & equipment	1,900	1,609
Goodwill	89	98
Investment in associate	170	55
Other investments	68	68
Financial assets	78	103
	2,305	1,933
Current		
Inventories	122	136
Trade receivables	230	256
Other receivables	36	45
Bank	170	166
	558	603
Total assets	**2,863**	**2,536**
Equity & liabilities		
Equity		
Equity share K1.00 each	900	780
Share premium	320	140
Revaluation reserve – Land	103	66
Retained earnings	550	156
Non – controlling interest	400	259
Total equity	2,273	1,401
Liabilities		
Non – current		
Deferred tax	84	109
Defined benefit plan	48	45
12% Loan notes	187	407
	319	561

Current		
Trade payables	148	400
Current tax	85	120
Interest payable	38	54
	271	574
Total liabilities	590	1,135
Total equity & liabilities	**2,863**	**2,536**

The following information is relevant:

(i) On 30th June 2014, Satu acquired 80% of the equity shares of Mutumba PLC for a cash consideration of K630 million. The fair value of non – controlling interest at that date was K160 million. The fair value of net assets of Mutumba Plc at acquisition was K760 million. This is summarised below:

	K'million
Property, plant and equipment	780
Inventory	23
Trade receivables	51
Bank	18
Trade payables	(38)
Deferred tax	(58)
Current tax	(16)
	760

(ii) On 30th September 2014, Satu disposed of 70% of the equity shares in Vaate PLC for cash consideration of K589 million. This left Satu with 20% equity shares in Vaate PLC fair valued at K150 million. Satu is able to exercise significant influence in Vaate PLC.

The fair value of net assets of Vaate PLC at the date of disposal are summarised below:

	K'million
Property, plant and equipment	650
Inventory	32
Trade receivables	66
Bank	12
Trade payables	(42)
Current tax	(28)
	690

Satu acquired the equity shares of Vaate PLC three (3) years ago for a cash consideration of K603 million when the fair value of its net assets stood at K650 million. The fair value of non – controlling interest at that date was K71 million.

The gain on the disposal of 70% equity shares in Vaate PLC has been included in other income.

(iii) Consolidated goodwill impaired for the year to 30th September 2014 relates to Maate PLC a subsidiary that was acquired two years ago. Satu has owned 75% of the equity shares in Maate PLC since acquisition date. The goodwill in other subsidiaries did not suffer any impairment loss.

(iv) A piece of land was revalued on 30th September 2014 by Satu.

(v) An item of plant, with a carrying value of K100 million, was disposed of on 31st August 2014 by Satu. 20% of the disposal value had not been paid by the buyer by 30th September 2014. This amount is shown as other receivables. The gain on disposal has been included in other income.

There was no other separate sale of an item of property, plant and equipment during the year to 30th September 2014.

Depreciation charged to cost of sales for the year ended 30th September 2014 amounted to K270 million.

(vi) The financial assets figure relates to financial assets classified as 'through profit or loss'. During the year to 30th September 2014, Satu sold for cash financial asset with a carrying value of K25 million at a profit of K50 million. This has been included in other income.

There was no acquisition of financial assets.

(vii) Satu acquired 22% equity shares in Meta PLC for cash consideration of K25 million on 30th December 2013. Satu is able to exercise significant influence in Meta PLC. Investments in associate were not impaired in the year to 30th September 2014.

There was no disposal of any investment in associate during the year.

(viii) Satu paid total contribution amounting to K15 million to a defined benefit plan. Pension benefits amounting to K19 million were paid during the year to 30th September 2014.

(ix) Satu maintains two accounts, Zambian Kwacha account and United States Dollars account. The company has maintained $1 million in the dollar account since 30th September 2013. This figure has been translated to Kwacha and included in total bank balance.

Kwacha to dollar exchange rates:

30th September 2013	K5.8000
Average rate for the year to 30th September 2014	K6.0000
30th September 2014	K6.2000

The exchange difference has been included in other income.

(x) Satu issued equity shares for cash on 31st May 2013.

(xi) The balance of other income relates to cash interest received from other investments. There was no acquisition and disposal of other investments.

(xii) Satu, its subsidiaries and associated companies paid dividends on 1st September 2014.

(xiii) It is Satu's policy to value non – controlling interest at fair value.

Required:

Prepare a consolidated statement of cash flow of Satu Group using the indirect method for the year ending 30th September 2014 in accordance with the requirements of IAS 7 'Statement of cash flows'. **[Total: 40 marks]**

SECTION B

Attempt any three questions in this section.

QUESTION TWO

Explain the accounting treatment of the transactions below for the year ended 30th September 2014.

(a) Lavada Limited commenced construction of a factory on 1st January 2014 after having surveyed and dug the foundation. The factory is expected to be completed on 31st December 2015 at a cost of K2,500 million. The factory will house the new machine, though yet to be acquired, needed to manufacture a new detergent paste to be called 'Wonders of washing'.

On 1st October 2013, the company got a bank loan of K2,500 million with annual interest of 10% which was equal to its effective interest rate. Its repayment period was 20 years starting 28th September 2015.

The following has been incurred from 1st January 2014 to 30th September 2014.

	K'million
Surveyors' fees	60
Material purchases	600
Labour costs	250
Overheads	200

Note:

- 20% of materials purchased are yet to be used by 30th September 2014.
- 10% of labour costs were paid on 1st November 2014.
- 30% of overhead costs relate to general overheads while the balance is directly attributable to the factory construction.
- Interest cost for the period to 30th September 2014 is not included in the figures above. It was paid on 15th October 2014.
- The company had no other loan.
- Buildings are depreciated at 10% per annum on cost.

Note: all the activities relating to the construction of the factory commenced on 1st January 2014. (7 marks)

(b) Vadala PLC acquired a piece of land at a cost of K200 million on 1st July 2014. The company has by 30th September 2014, not decided what to do with this land. The land has a fair value of K220 million on 30th September 2014. (2 marks)

(c) Meda PLC has owned a drilling machine for the past three (3) years. The machine has been used on several projects, generating 12% of the company's total revenue. In recent years, the company has experienced unprecedented competition in the drilling business which has led to a drastic reduction in revenue from this business to about 6% of the total company revenue. This trend is expected to continue in the foreseeable future. The directors of Meda PLC are therefore, thinking of abandoning the drilling machine on 31st October 2014 and have thus classified it as 'held for sale' as at 30th September 2014. (7 marks)

(d) Nadana Enterprises buys goods on credit from Tedana PLC. The terms of the contract are that:

i) The goods are insured by Nadana Enterprises.

ii) Nadana Enterprises pays for the goods after it has sold them and cash has been received in respect of those goods.

iii) Nadana Enterprises has the right to return unsold goods to Tedana PLC within one month from the date of purchase. Nadana Enterprises has returned goods to Tedana PLC before.

All the goods that Nadana Enterprises still has in its books, for the period to 30th September 2014, were bought on 20th September 2014. The goods have not yet been sold by Nadana Enterprises as at 30th September 2014. (4 marks)

[Total: 20 marks]

QUESTION THREE

Maambana Limited introduced two pension plans, 'Push' plan and 'Mega' plan on 1st January 2013 for Management staff and for the rest of the employees respectively.

Details of each plan are as follows:

Push plan

Under this plan, Maambana Limited is required to make a fixed annual contribution to the fund. In addition, its legal or constructive obligation is limited to the fixed contribution it has to make to the fund. Moreover, employees are required to contribute 10% of the total pension contribution to the scheme.

On 1st January 2013, total contributions of K100 million were paid into the fund. This represents pension contributions for three (3) years. The company expensed the all amount to the statement of profit or loss for the year ending 30th September 2013. Conversely, no amount has been expensed in the year to 30th September 2014.

The scheme had fair value of plan assets of K100 million and present value of plan obligation of K120 million at 1st January 2013. The balances for the fair value of plan assets and present value of plan obligations increased to K110 million and K140 million respectively as at 30th September 2014. These have not been recorded anywhere in the books of Maambana Limited.

Mega plan

The terms of this plan require Maambana Limited to guarantee post employment benefits to its employees.

The fair value of plan assets and the present value of plan obligations amounted to K140million and K190 million respectively at 30th September 2013. The balances at 30th September 2014 were K195 million for the fair value of plan assets and K210 million for the present value of plan obligations. On 1st January 2013, fair value of plan assets was equal to the contribution paid by Maambana Limited into the fund amounting to K100million. The present value of plan obligation was valued at K120 million at the same date.

During the year to 30th September 2014 the company reduced the benefits which employees are entitled to under this plan by K20 million. This amounted to K12 million in the previous year. The present value of plan obligation increased by K18 million and K19 million in the years ended 30th September 2013 and 30th September 2014 respectively. Further, the company contributed a total sum of K40 million at 1st October 2013.

No pension benefits have been paid out by the company in both years.

The company recorded in its financial statements for the years to 30th September 2013 and 30th September 2014 fair value of plan assets under non-current assets and present value of plan obligation under non-current liabilities. The differences between present value of plan obligations and fair value of plan assets were taken to statement of profit or loss as either income or expense items. The contributions paid were correctly accounted for in the financial statements. However, the other items relating to the pension plan were not recorded in the financial statements.

The annual discount rate for the year to 30th September 2013 was 10% and 12% for the year to 30th September 2014.

Required

(i) Distinguish between a defined contribution plan and a defined benefit plan. (5 marks)

(ii) Explain the accounting treatment of the two plans in the financial statements of Maambana Limited and the accounting entries required to correctly account for them in both 2013 and 2014 financial statements. (15 marks)

[Total: 20 marks]

QUESTION FOUR

IFRS 9 'Financial Assets' covers recognition, derecognition, classification and measurement of financial assets and financial liabilities. The way financial assets and financial liabilities are accounted for in the financial statements depends on their classification. Their classification depends on meeting certain criteria.

(a) Explain the criteria that have to be met for a financial asset to be classified as either fair value through profit or loss, fair value through other comprehensive income or amortised cost. (6 marks)

(b) Explain the adjustments that should be made to the financial statements of Batara Limited for the year ending 30th November 2014 to correctly account for the following transactions.

(i) Batara Limited issued a three-year convertible bond of K100 million on 1st December 2013. The issue costs amounted to 10% of the bond value. The bond has an annual coupon rate of 12%. The effective interest rate of a bond without conversion rights and excluding the effects of issue costs is 14% per annum. 16% is the estimated annual effective interest rate of the bond with no conversion rights, after taking into account the effects of issue costs.

The accountant of Batara Limited accounted for the cash raised correctly. However, the bond is shown under non-current liabilities at a value of K100 million. The issue costs have been expensed. Interest for the year to 30th November 2014 has been calculated based on K100 million using the annual interest rate of 10%. The interest has been expensed and duly paid.

Batara Limited is only interested in payments of annual interest and principal repayment at the end of three years. (7 marks)

(ii) Batara Limited acquired 18% of the equity shares in Kalala PLC for cash consideration of K30 million on 1st December 2013. Transaction costs amounting to K2 million were incurred to acquire the shares. The company has no intention of selling these shares and it does not have significant influence in Kalala PLC.

The cash paid by Batara Limited to acquire the shares was correctly accounted for in its books. The transaction costs have been expensed while the 18% shareholding accounted for using the equity method. The fair value of these shares at 30th November 2014 was K43 million.

Kalala Plc profit for the year to 30th November 2014 amounted to K400 million. It paid out total dividends of K100 million to all of its shareholders for the year to 30th November 2014. (7 marks)

[Total: 20 marks]

QUESTION FIVE

(a) IFRS 11 'Joint arrangements' classifies joint arrangements as either joint ventures or joint operations. This classification is important for them to be accounted for correctly in both separate and consolidated financial statements.

Required

i) Distinguish between a joint venture and a joint operation. (4 marks)

ii) Explain how joint ventures and joint operations are accounted for in both separate and consolidated financial statements. (6 marks)

(b) Bacata Plc acquired 18,000 of 112,500 issued equity shares of Catala PLC on 1st March 2014 for a cash consideration of K54 million. Bacata PLC was given one seat on Catala PLC's board of directors.

During the year to 30th November 2014, sales between Bacata PLC and Catala PLC accounted for 30% of Bacata PLC's total sales.

Catala PLC had made a loss of K10 million for the year to 30th November 2014. It did not therefore pay out any dividends in the year to 30th November 2014.

The investment in Catala PLC was fair valued at K70 million on 30th November 2014.

Required

Discuss how equity shares acquired in Catala PLC should be accounted for in the separate and consolidated financial statements of Bacata PLC for the year to 30th November 2014. (10 marks)

[Total 20 marks]

END OF PAPER

Present Value Table

Present value of 1 i.e. $(1 + r)^{-n}$

Where r = discount rate
n = number of periods until payment

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	0·980	0·961	0·943	0·925	0·907	0·890	0·873	0·857	0·842	0·826	2
3	0·971	0·942	0·915	0·889	0·864	0·840	0·816	0·794	0·772	0·751	3
4	0·961	0·924	0·888	0·855	0·823	0·792	0·763	0·735	0·708	0·683	4
5	0·951	0·906	0·863	0·822	0·784	0·747	0·713	0·681	0·650	0·621	5
6	0·942	0·888	0·837	0·790	0·746	0·705	0·666	0·630	0·596	0·564	6
7	0·933	0·871	0·813	0·760	0·711	0·665	0·623	0·583	0·547	0·513	7
8	0·923	0·853	0·789	0·731	0·677	0·627	0·582	0·540	0·502	0·467	8
9	0·941	0·837	0·766	0·703	0·645	0·592	0·544	0·500	0·460	0·424	9
10	0·905	0·820	0·744	0·676	0·614	0·558	0·508	0·463	0·422	0·386	10
11	0·896	0·804	0·722	0·650	0·585	0·527	0·475	0·429	0·388	0·305	11
12	0·887	0·788	0·701	0·625	0·557	0·497	0·444	0·397	0·356	0·319	12
13	0·879	0·773	0·681	0·601	0·530	0·469	0·415	0·368	0·326	0·290	13
14	0·870	0·758	0·661	0·577	0·505	0·442	0·388	0·340	0·299	0·263	14
15	0·861	0·743	0·642	0·555	0·481	0·417	0·362	0·315	0·275	0·239	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	0·812	0·797	0·783	0·769	0·756	0·743	0·731	0·718	0·706	0·694	2
3	0·731	0·712	0·693	0·675	0·658	0·641	0·624	0·609	0·593	0·579	3
4	0·659	0·636	0·613	0·592	0·572	0·552	0·534	0·516	0·499	0·482	4
5	0·593	0·567	0·543	0·519	0·497	0·476	0·456	0·437	0·419	0·402	5
6	0·535	0·507	0·480	0·456	0·432	0·410	0·390	0·370	0·352	0·335	6
7	0·482	0·452	0·425	0·400	0·376	0·354	0·333	0·314	0·296	0·279	7
8	0·434	0·404	0·376	0·351	0·327	0·305	0·285	0·266	0·249	0·233	8
9	0·391	0·361	0·333	0·308	0·284	0·263	0·243	0·225	0·209	0·194	9
10	0·352	0·322	0·295	0·270	0·247	0·227	0·208	0·191	0·176	0·162	10
11	0·317	0·287	0·261	0·237	0·215	0·195	0·178	0·162	0·148	0·135	11
12	0·286	0·257	0·231	0·208	0·187	0·168	0·152	0·137	0·124	0·112	12
13	0·258	0·229	0·204	0·182	0·163	0·145	0·130	0·116	0·104	0·093	13
14	0·232	0·205	0·181	0·160	0·141	0·125	0·111	0·099	0·088	0·078	14
15	0·209	0·183	0·160	0·140	0·123	0·108	0·095	0·084	0·074	0·065	15

Annuity Table

Present value of an annuity of 1 i.e. $\frac{1-(1+r)^{-n}}{r}$

Where r = discount rate
n = number of periods

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2·487	3
4	3·902	3·808	3·717	3·630	3·546	3·465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3·890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4·486	4·355	6
7	6·728	6·472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7·435	7·108	6·802	6·515	6·247	5·995	5·759	9
10	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6·418	6·145	10
11	10·37	9·787	9·253	8·760	8·306	7·887	7·499	7·139	6·805	6·495	11
12	11·26	10·58	9·954	9·385	8·863	8·384	7·943	7·536	7·161	6·814	12
13	12·13	11·35	10·63	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
14	13·00	12·11	11·30	10·56	9·899	9·295	8·745	8·244	7·786	7·367	14
15	13·87	12·85	11·94	11·12	10·38	9·712	9·108	8·559	8·061	7·606	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2·444	2·402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2·690	2·639	2·589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4·111	3·998	3·889	3·784	3·685	3·589	3·498	3·410	3·326	6
7	4·712	4·564	4·423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4·799	4·639	4·487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4·451	4·303	4·163	4·031	9
10	5·889	5·650	5·426	5·216	5·019	4·833	4·659	4·494	4·339	4·192	10
11	6·207	5·938	5·687	5·453	5·234	5·029	4·836	4·656	4·486	4·327	11
12	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4·439	12
13	6·750	6·424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
14	6·982	6·628	6·302	6·002	5·724	5·468	5·229	5·008	4·802	4·611	14
15	7·191	6·811	6·462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

P1 SUGGESTED SOLUTIONS

SOLUTION ONE

Satu Group
Consolidated statement of cash flow for the year ended 30th September 2014.

	K'million	K'million
Cash flow from operating activities		
Profit before tax		585
Adjustments for:		
Interest expense		35
Goodwill impairment loss W8		15
Depreciation charge		270
Share of associate profit		(90)
Other income		(250)
Defined benefit plan expense W5		18
		583
Decrease in inventories 136+23-32-122		5
Decrease in trade receivables 256+51-66-230		11
Decrease in other receivables		45
Decrease in trade payables 400+38-42-148		(248)
Cash generated from operations		396
Tax paid W9		(191)
Interest paid W10		(51)
Contribution paid – defined benefit plan		(15)
Net cash inflow from operating activities		139
Cash flow from investing activities		
Dividends from investment in associate W7	150	
Cash paid to acquire property, plant and equipment W6	(494)	
Proceeds from disposal of plant (80/20 x K36m)	144	
Cash paid to acquire Mutumba Plc 630-18	(612)	
Proceeds from disposal of Vaate Plc 589-12	577	
Interest from other investment W4	19.6	
Proceeds from disposal of financial assets W4	75	
Cash paid to acquire shares in Meta Plc	(25)	

Net cash outflow from investing activities		(165.4)
Cash flow from financing activities		
Dividends paid to non-controlling interest W1	(26)	
Dividends paid W11	(24)	
Repayment of 12% loan notes 407-187	(220)	
Proceeds from issue of shares 900+320-780-140	300	
Net cash inflow from financing activities		30
Cash flow changes in cash and cash equivalent		3.6
Non-cash flow changes in cash & cash equivalents 6.2-5.8		0.4
Total changes in cash & cash equivalents		4.0
Opening cash and cash equivalent		166
Closing cash and cash equivalent 144 -0.4		170

Workings

W1 Non-controlling interests

	K'million
Opening balance	259
Other comprehensive income	82
Mutumba Plc	160
Vaate Plc 71+{10% x (690-650)}	(75)
Dividends paid (bal. fig)	(26)
Closing balance	400

W2 Disposal of 70% equity shares in Vaate Plc

	K'million
Proceeds	589
Fair value of retained interest	150
Non-controlling interest W1	75
Fair value of net assets at disposal:	
Tangible assets	(690)
Goodwill (603+71)-650	(24)
Gain on disposal	100

W3 Disposal of plant

	K'million
Proceeds 100/20 x K36m	180
Carrying amount	(100)
Profit on disposal	80

W4 Disposal of financial assets

	K'million
Proceeds (bal.fig)	75
Carrying amount	(25)
Profit on disposal	50

Therefore, Cash interest received = 250-100-80-50-0.4(6.2-5.8) = K19.6million

W5 Defined benefit plan

	K'million
Opening balance	45
Net expense (bal.fig)	18
Net actuarial gain	0
Contribution paid	(15)
Closing balance	48

W6 Property, plant and equipment

	K'million
Opening balance	1,609
Revaluation surplus	37
Mutumba Plc	780
Vaate Plc	(650)
Disposal of plant	(100)
Depreciation charge	(270)
Cash paid (bal.fig)	494
Closing balance	1,900

W7 Investment in associate

	K'million
Opening balance	55
Vaate Plc	150
Meta Plc	25
Statement of profit or loss	90
Dividends received (bal.fig)	(150)
Closing balance	170

W8 Goodwill

	K'million
Opening balance	98
Mutumba Plc (630+160)-760	30
Vaate Plc (603+71) -650	(24)
Impairment loss (bal.fig)	(15)
Closing balance	89

W9 Taxation

	K'million
Opening balances 109+120	229
Statement of Profit or loss	85
Mutumba Plc 58+16	74
Vaate Plc	(28)
Cash paid (bal.fig)	(191)
Closing balance 84+85	169

W10 Interest payable

	K'million
Opening balance	54
Statement of profit or loss	35
Cash paid (bal.fig)	(51)
Closing balance	38

W11 Retained earnings

	K'million
Opening balance	156
Profit for period attributable to parent	418
Dividends paid (bal.fig)	(24)
Closing balance	550

SOLUTION TWO

a) Construction of factory

The factory will be recognised as part of non-current assets in the statement of financial position at the total costs incurred that is directly related to construction. The surveyors' fees of K60million will be capitalised. Only 80% of material costs amounting to K480million should be capitalised while 20% of the cost amounting to K120million should be shown under current assets as part of inventory figure. This is because the materials have to yet been used.
K250million of labour cost will be part of the cost of the factory. In addition, the 10% of the labour cost of K25million will be shown under current liabilities as it has not yet been paid. Only overheads that are directly attributable to the construction of the factory should be capitalised. This is equal to K140million. The amount of K60million relating to general overheads should be expensed. The interest cost to be capitalised should be for the period when activities relating to the construction of the factory were taking place. This is only nine (9) months for the year to 30th September 2014. This gives a cost of K187.5million to be capitalised. The amount of K62.5million should be expensed. There is no need to compute the capitalisation rate as there is only one loan. The total interest cost of K250million should be shown under current liabilities as it had not been paid at 30th September 2014. The first capital repayment of the loan is on 28th September 2015. This means that the total loan of K2,500 million should be split into two, the amount payable in the year to 30th September 2015 and that payable after 30th September 2015. This gives K125million and K2,375 million to be recognised under current liabilities and non-current liabilities respectively in the statement of financial position.
The factory will thus be capitalised at a cost of K992.5million. No depreciation will be charged as the factory has not yet been completed.

b) Piece of land

The land acquired for use in business operations is shown as part of property, plant and equipment and accounted for under IAS 16 'Property, plant and equipment'. However, where an entity is yet to decide on its use, then it should be classified as investment property and accounted for under IAS 40 'Investment property'. The land will initially be recognised at K200 million on 1st July 2014 and subsequently at K220 million to reflect its fair value at 30th September 2014. The increase in fair value of K20 million will be recognised as a gain in the statement of profit or loss. This is in accordance with the fair value model of IAS 40 'Investment property'. However, under the cost model of IAS40, the land will be carried at its cost of K200million subject to impairment review. The land should not be revalued under this model.

c) Drilling machine

IFRS 5 "Non-current assets held for sale and discontinued operations' requires an asset whose value will be realised through sale to be classified as held for sale as long as certain criteria are met. These include the following:

- The asset must be available for immediate sale in its present condition.
- Its sale must be highly probable.

For the sale to be highly probable,

- Management must be committed to a plan of sale.
- There must be an active programme to locate a buyer.
- The price of the asset should be reasonable in relation to its current fair value.
- The sale must be expected to take place within one year from the date of classification.

Conversely, an asset that is to be abandoned, except for a disposal group, should not be classified as held for sale. This is because its carrying amount will be recovered by continuing use.

The drilling machine should therefore not be classified as held for sale as it does not meet the recognition criteria. Its carrying value will be realised through continued use and not through sale. Meda Plc should continue accounting for the machine under IAS 16 'Property, plant and equipment'. In addition, the continued reduction in the revenue contribution of the asset is an indicator of impairment. The asset should therefore, be reviewed for impairment. If its carrying value turns out to be more than its recoverable value, it should be reduced to its recoverable amount and impairment loss taken to the statement of profit or loss.

d) Goods bought from Tenada Plc

For the goods to be recognised in the books of Nadana Enterprises, ownership has to be established. It is vital to determine the point at which ownership of goods is transferred to Nadana Enterprises. Looking at the terms of the transaction, it seems Nadana Enterprises owns the goods immediately they are bought. This is because it is responsible for insuring them. In addition we are not told if Nadana Enterprises gets to be refunded or the selling price reduced to reflect insurance cost borne by Nadana Enterprises. However, the risk of irrecoverable debts is not transferred to Nadana Enterprises as it only pays for the goods once paid for by its customers. This means that, in an instance where Nadana Enterprises customers fail to pay, the cost is borne by Tenada Plc. Moreover, Nadana Enterprises has a right to return the goods to Tenada Plc

within one month from the date of purchase and this has been exercised before. These show that the risks and rewards of ownership of goods are not transferred to Nadana Enterprises till after one month.
Nadana Enterprises should recognise sales revenue from these goods once customers have paid. For the goods not yet paid for, a sale recognised after a month has elapsed. In addition, goods that have not yet been sold by Nadana Enterprises will only be part of its inventory figure after one month has passed. The goods in question should therefore, not be recognised as part of its inventory figure in its financial statements as they are yet to be sold and paid for and are less than one month from the date of purchase.

SOLUTION THREE

a) Distinction between defined benefit plan and defined contribution plan

Under a defined benefit plan the company guarantees post employment benefits to the employees. That is, if the fund's assets are not adequate to cover employees' benefits, then the employer may be required to settle the shortfall. This means that investment risk of the plan rests with the employer. In addition, the employer accounts for net pension assets or net pension liability in its financial statements.

Under a defined contribution plan, the employer's obligation is limited to what has been agreed as its contribution to the plan. The investment risk, therefore, rests with the employees. The employer only accounts for the contribution in its financial statements.

b) Push Plan

This is a defined contribution plan as the obligation of Maambana Limited is limited to fixed contribution it has to make to the plan. It should only account for the contribution made by it to the fund. The contribution made by the employees to the fund has to be excluded from its financial statements.
The total contribution of K90million (90% x K100m) made by the company for covering a three year period should not be accounted for in one accounting year but spread over the period to which the amount relates, that is three years. Amounts of K22.5million (K90m/3yrs x 9/12) and K30million (K90m/3yrs) should be recognised in the statement of profit or loss for the years to 30th September 2013 and 30th September 2014 respective. This implies that an amount of K77.5million (K100m – K22.5m) has to be reversed in the period to 30th September 2013. A prepayment of K67.5million and K37.5million should be recognised in the statements of financial position as at 30th September 2013 and 30th September 2014 respectively. The net plan assets or net plan obligation will not be recognised in the financial statements of Maambana Limited.

Mega Plan

This is a defined benefit plan. This is because Maambana Limited guarantees post employment benefits to its employees. That is, investment risk of the fund rests with Maambana Limited.

The company should have recognised a net plan liability of K50m (W5) as at 30th September 2013 and K15m (W5) at 30th September 2014. Therefore, K140m (190 – 50) and K195m (210 – 15) should be deducted from non-current liabilities as at 30th September 2013 and 30th September 2014 respectively. Further, Maambana Limited should not have recognised any asset as at 30th September 2013 and 30th September 2014. K140m and K195m recorded in non-current assets should thus be reversed in the statements of financial position as at 30th September 2013 and 30th September 2014 respectively.

Moreover, Maambana Limited should have recognised net expense of K127.5m (W3) and K0.2m (W3) in the statements of profit or loss for the year ending 30th September 2014 and 30th September 2014 respectively. K50m (190 – 140) loss and K15m (210 – 195) loss were recognised in the statements of profit or loss for the year ending 30th September 2013 and 30th September 2014 respectively. K42.5m (50 – 7.5) and K14.8m (15 – 0.2) have to be credited to the statements of profit or loss or retained earnings for the year to 30th September 2013 and 30th September 2014 respectively.

Workings

W1 Fair value of plan assets

		K'million
1st Jan. 2013 Contribution paid		100
30th Sept. 2013	Return 10% x 100 x 9/12	7.5
30th Sept. 2013	Actuarial gain (bal.fig)	32.5
Balance at 30th Sept. 2013		140
1st Oct. 2013 Contribution paid		40
30th Sept. 2014	Return 12% x (140+40)	21.6
30th Sept. 2014	Actuarial loss (bal.fig)	(6.6)
Balance at 30th Sept. 2014		195

W2 Present value plan obligation

		K'million
Balance at 1st January 2013(past service cost)		120
30th Sept. 2013	Interest 10% x 120 x 9/12	9
30th Sept. 2013	Current service cost	18
30th Sept. 2013	Past service cost	(12)
30th Sept. 2013	Actuarial loss (bal.fig)	55
Balance at 30th Sept. 2013		190
30th Sept. 2014	Interest 12% x 190	22.8
30th Sept. 2014	Current service cost	19
30th Sept. 2014	Past service cost	(20)
30th Sept. 2014	Actuarial gain (bal.fig)	(1.8)
Balance at 30th September 2014		210

W3 Net expense

		30th September 2013 K'million	2014 K'million
Interest W2		9	22.8
Return W1		(7.5)	(21.6)
Current service cost		18	19
Past service cost	(120-12)	108	(20)
Net expense		127.5	0.2

W4 Net actuarial gain

		30th September 2013 K'million	2014 K'million
Actuarial loss/(gain):	Fair value of plan assets W1	(32.5)	6.6
	Present value of plan obligation W2	55	(1.8)
Net actuarial loss		22.5	4.8

W5 Net plan liability

	30th September 2013 K'million	2014 K'million
Present value of plan obligation	190	210
Fair value of plan assets	(140)	(195)
Net plan liability	50	15

SOLUTION FOUR

a) The criteria that have to be met for a financial asset to be classified as either fair value through profit or loss, fair value through other comprehensive income or amortised cost are as follows:

Fair value through profit or loss

i. The classification is applicable to both debt or equity instruments
ii. The debt or equity instrument must be held for trading. This means that an entity may realise the value of a financial asset at anytime through selling.
iii. The classification also applies to derivative instruments. All derivative instruments are classified as fair value through profit or loss.

Fair value through other comprehensive income

i. This only applies to equity instruments and not debt instruments. Usually debt instrument that is not held for trading is classified under amortised cost. This however, is subject to meeting the business model and cash flow characteristics tests.
ii. It must not be held for trading. An entity should not be interested in realising the value of a financial asset through a sale but in deriving economic benefits through receipt of dividends and capital gains as the fair value of shares increase.

Amortised cost

i. This is a restrictive classification as it only applies to debt instruments and not to equity instruments.
ii. The debt instrument should of course not be held purely for trading. The entity should not acquire it for the sole purpose of realising its value through selling.
iii. The two tests of business model and cash flow must be met. Under the cash flow characteristic test, the contractual terms of the financial asset

should give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. While under the business model test, a financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

b) i) **Convertible bonds**

The company is interested in payments of annual interest and principal. The convertible bond should therefore, have been carried at amortised cost. The bond should have been split into two, liability component and equity component. The liability component should have been recognised under non-current liabilities at amortised cost while the equity component under equity.

The liability component should have been calculated by getting the sum of interest and principal discounted at 14% giving K95.36million (W1). The equity component represents residual interests of K4.64million (W1). The two components should have been adjusted for issue costs of K10million (10% x K100million). This is allocated to the components based on their book values; K9.54million (W2) to liability and K0.46million (W2) to equity. This gives revised liability and equity components figures of K85.82million (W2) and K4.18million (W2) respectively. The liability component of K85.82million is amortised at 16% to get K89.55million (W3) the balance that should have been shown under non-current liabilities at 30th November 2014. In addition, interest cost of K13.73million (W3) should have charged to the statement of profit or loss.

Adjustments to be made to the financial statements:

I. Equity should be increased by K4.18million (W2) to reflect the equity component of the convertible bond.
II. The bond amount under non-current liabilities should be reduced by K10.45million (K100million – K89.55million).
III. Retained earnings increased by K6.27million (W4).

ii) **Equity shares**

The 18% equity shares should have been classified as financial assets through profit or loss. This is because the company has no significant influence in Kalala Plc and the shares are not for trading. The shares should have initially been recognised at a value of K32million (30+2) inclusive of transaction costs. At 30th November 2014 should have been fair valued to K43million and the increase in fair value of K11million taken to other comprehensive income and other components of equity.

Dividends of K18million (18% x K100million) would have been the income recognised in the statement of profit or loss.

Adjustments to be made to the financial statements

I. The investment in associate amounting to K84million (W5) should be reversed and financial assets through other comprehensive income recognised at a fair value of K43million. This will result in non-current assets reducing by K41million.
II. Other components of equity should be increased by K11million.
III. Profit for the year and retained earnings should be reduced by K52million (W6).

Workings

1. Liability and equity components

Years		K'm	DF@14%	K'm
1-3	Interest (12%xK100m)	12	2.322	27.86
3	Principal	100	0.675	67.50
Liability component				95.36
Equity component (bal.fig)				4.64
Bond proceeds				100

2. Allocation of K10million (10% xK100million) issue costs

	Liability	Equity
	K'm	K'm
As per W2	95.36	4.64
Transaction cost	(9.54)	(0.46)
	85.82	4.18

3. Amortisation of liability component

	K'm
Balance at 1st December 2013	85.82
Interest @16%	13.73
Cash flow (10% x K100m)	(10.00)
Balance at 30th November 2014	89.55

4. Retained earnings adjustment

	K'm
Issue costs reversal	10
Interest @ 10% reversal	10

Interest @ 16% (W3)	(13.73)
	6.27

5. Investment in associate

	K'm
Cost of investment	30
Share of profit for period (18% x K400m)	72
Share of dividends (18% x K100m)	(18)
	84

6. Retained earnings adjustment

	K'm
Transaction costs reversal	2
Share of profit reversal	(72)
Share of dividends	18
	(52)

SOLUTION FIVE

a) (i) **Distinction between joint venture and joint operation**

Under a joint venture the parties with joint control of the arrangement have rights to the net assets of the arrangement. While under a joint operation, the parties with a joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement. In addition, in a joint venture the assets brought into the arrangement or subsequently acquired by the joint arrangement are arrangement's assets. The parties have no title or ownership to the assets. While in a joint operation, the parties share all interests in the assets relating to the arrangement in a specified proportion. Creditors of the joint arrangement do not have rights of recourse against any party in a joint venture. However, parties to the joint operation are liable for claims by third parties.

(ii) **Accounting for joint operations**

Joint ventures

These are accounted for in consolidated financial statements of the investor using the equity method. While in separate financial statements, the investor accounts for them under IFRS 9' Financial instruments', as either financial assets through profit or loss or financial assets through other comprehensive income.

Joint operations

The joint operator recognises line by line, in both separate financial statements and consolidated financial statements, the following items:

- Its assets, including its share of any assets held jointly,
- Its liabilities, including its share of any liabilities incurred jointly,
- Its revenue from the sale of its share of the output of the joint operation,
- Its share of the revenue from the sale of the output by the joint operation,
- Its expenses, including its share of any expenses incurred jointly.

In addition, a joint operator accounts for the assets, liabilities, revenues and expenses relating to its interest in the joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses.

b) Equity shares acquired in Catala Plc

It is important to establish whether the acquired equity shares in Catala Plc give rise to Bacata Plc having an associated company or simply a trade investment. IAS 28 states that significant influence has to exist for an investment to be accounted for as an associated company in consolidated financial statements. Otherwise it may either be accounted for as investment in a subsidiary, if control exists, or as trade investment. IAS 28 states that significant influence is presumed to exist if the investor owns atleast 20% of the voting power, equity shares, of the investee. However, if the investor owns less than 20% of the equity shares of the investee, then significant influence has to be demonstrated. This is evidenced in one or more of the following ways:

i) Bacata Plc should have representation on the board of directors of Catala Plc
ii) Bacata Plc's participation in the policy making process of Catala Plc
iii) There should be material transactions between Bacata Plc and Catala Plc
iv) There should be interchange of management personnel between the two companies and
v) Provision of technical information

Bacata Plc acquired 16% (18,000/112,500) of Catala Plc. This is less than 20% prescribed by IAS 28 for significant influence to be presumed to exist. However, Bacataa Plc has one seat on the board of director that may enable it participate in the decision making process of Catala Plc. In addition, sales of 30% of Bacata Plc are significant. These two points demonstrate that there is significant influence despite the shareholding being less than 20%.

Catala Plc will therefore, be carried in the consolidated financial statements of Bacata Plc as an associated company.

Accounting

In separate financial statements of Bacata Plc, investment in Catala Plc will be recognised in the statement of financial position as at 30th November 2014 at a fair value of K70million under non-current assets. The shares will either be classified as financial assets through profit or loss or financial assets through other comprehensive income. The choice of classification will largely depend on whether the shares are held for trading or not. If they are for trading then financial assets through profit or loss will be appropriate. Otherwise, they should be classified as financial assets through other comprehensive income. The K16million (K70million – K54million) increase in fair value for the year to 30th

November 2014, is recognised as a gain in the statement of profit or loss if classified as financial assets through profit or loss and in other comprehensive income if classified as financial assets through other comprehensive income.

In consolidated financial statements, K52.80million (W1) is recognised as investment in associate company as at 30th November 2014, under non-current assets in the consolidated statement of financial position and K1.20million (W1) Bacata Plc's share of loss for the year in Catala Plc will be taken to the consolidated statement of profit or loss and deducted from or added to group's profit before tax or group's loss figure for the year.

Working

W1 Investment in associate

	K'million
Cost of investment	54
Share of post acquisition retained earnings 16% x 10 x 9/12	(1.20)
Balance to statement of financial position	52.80

END OF SUGGESTED SOLUTIONS