CHARTERED ACCOUNTANTS EXAMINATIONS

PROFESSIONAL LEVEL

P1: ADVANCED FINANCIAL REPORTING

MONDAY 13 JUNE 2016

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. **Cell Phones** are **NOT** allowed in the Examination Room.

6. 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.

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

8. Present legible and tidy work.

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

10. 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 draft statements of financial position relate to Maba Plc, Sasa Plc and Zana Plc as at 31 March 2016.

	Maba Plc K'000	Sasa Plc K'000	Zana Plc K'000
Assets			
Non – current assets			
Property, plant and equipment	384	420	567
Investments in:			
Nava Limited	120		
Sasa Plc	337		
Zana Plc	79	260	.....
	920	680	567
Current assets			
Inventory	55	45	35
Trade receivables	125	115	105
Cash and cash equivalents	65	75	85
	245	235	225
Total assets	**1,165**	**915**	**792**
Equity and liabilities			
Equity			
Equity shares of K0.80 each	400	320	240
Other components of equity	160	150	140
Retained earnings	130	120	110
Total equity	**690**	**590**	**490**
Liabilities			
Non – current liabilities	220	180	170
Current liabilities	255	145	132
Total liabilities	**475**	**325**	**302**
Total equity and liabilities	**1,165**	**915**	**792**

The following information is relevant in the preparation of group accounts.

1. Sasa Plc acquired 70% of Zana Plc's equity shares on 1 April 2014 for a cash consideration of K260,000. The fair value of Zana Plc's identifiable net assets stood at K360,000. On the same date, other components of equity and retained earnings were K70,000 and K40,000 respectively. The excess in fair value relates to non – depreciable land.

2. Maba Plc acquired 60% of Sasa Plc's equity shares and 20% of Zana Plc's equity shares on 1 April 2015 for cash consideration of K337,000 and K79,000 respectively. The fair values of identifiable net assets stood at K545,000 and K415,000 in Sasa Plc and Zana Plc respectively. On the same date, other components of equity were K130,000 in Sasa Plc and K100,000 in Zana Plc. Retained earnings on the other hand were K90,000 and K60,000 in

Sasa Plc and Zana Plc respectively. Excess in fair values relate to non – depreciable land of Zana Plc and an item of plant of Sasa Plc. The Plant has an economic useful life of five (5) years on 1 April 2015.

3. Sasa Plc and Zana Plc have not issued any additional shares since being acquired by Maba Plc. Further, fair value adjustments referred to in (1) and (2) above have not been incorporated in the above statements of financial position.

4. Investments in Sasa Plc and Zana Plc are classified as financial assets through other comprehensive income in accordance with IFRS 9 '*Financial instruments*'. The fair values of investments in Sasa Plc and Zana Plc had not significantly changed since acquisition date. They are therefore recorded in the above statements of financial position at their respective costs.

5. It is group policy to value non-controlling interests using proportion of net assets method.

6. On 1 April 2015 Maba Plc disposed of 60% equity interests in Nava Limited for cash consideration of K180,000. It acquired 100% of the equity shares of Nava Limited six (6) years ago for cash consideration of K300,000 when the fair value of Nava Limited's identifiable net assets were K280,000. At 1 April 2015 the fair values of Nava Limited's identifiable net assets and 40% retained interests in Nava Limited were K290,000 and K120,000 respectively. Purchased goodwill in Nava Limited has not been impaired since its acquisition. Maba Plc has significant influence in Nava Limited at 40% shareholding.

   Maba Plc adjusted cost of investment by cash received and it recognised neither a profit nor a loss in its financial statements as a result of this disposal. Further, Cash received was correctly recorded in its books.

   During the year to 31 March 2016, Nava Limited made a profit after tax of K10,000.

7. Maba Plc completed construction of a filling station at a cost of K200,000 on 31 March 2015. Maba Plc is required by the Energy Sector Regulators to dismantle the filling station and restore the land to its original state after 20 years. This will cost Maba Plc K20,000 in 20 years' time.
   Maba Plc has not yet accounted for the K20,000 in its financial statements for the year to 31 March 2016. However, the cost of K200,000 has been correctly recorded in the books of Maba Plc.

   Note: Ignore discounting and assume that the cost of K200,000 has been correctly calculated.

8. At 31 March 2016, goodwill in Sasa Plc and Zana Plc has not been impaired.

Required:

Prepare a consolidated statement of financial position of Maba Plc group as at 31 March 2016 in accordance with International Accounting Standards and International Financial Reporting Standards.

[Total: 40 Marks]

SECTION B

Attempt any THREE (3) questions from this section

QUESTION TWO

(a) The following are extracts of financial statements of Casa Plc:

Statement of profit or loss (extract) for the year ended 31 March 2016

	K'000
Revenue	900
Profit from continuing operations after tax	84
Profit from discontinued operations after tax	42
Income tax (on discontinued operations K18,000)	54

Statement of financial position (extract) as at 31 March 2016

	K'000
Equity shares of K0.60 each	150
Total reserves	80
Non – current liabilities	100

Casa Plc uses two key ratios, return on capital employed (ROCE) and earnings per share (EPS) to assess its performance. The ROCE and EPS for the year ended 31 March 2015 were 40% and K0.25 per share respectively.

The following transaction, in addition to other transactions, took place during the year to 31 March 2016.

Transaction

Casa Plc introduced a defined benefit pension scheme for its employees on 1 April 2014. The net plan assets at 31 March 2015 was K20,000. The scheme had net expense of K80,000 and net actuarial losses of K8,000. Casa Plc contributed K10,000 to the scheme and the scheme paid out pension benefits amounting to K4,000.

Casa Plc has recorded contribution paid as an expense in addition to the entry in its cash book for the same amount. This was aimed at improving its performance for the year to 31 March 2016.

Required:

(i) Calculate current ROCE and EPS for the year ended 31 March 2016. (4½ marks)

(ii) Recalculate ROCE and EPS after taking into account the correct accounting treatment of the transaction above. (5½ marks)

(b) You are the accountant of Sanata Plc. Your company sent you for an International Accounting Standards and International Financial Reporting Standards workshop organised by the Zambia Institute of Chartered Accountants. The main highlight of the workshop was IFRS 15 '*Revenue from contract with customers*'. You learnt that the standard applies five (5) steps model to revenue recognition:

- Step 1 - Identify the contract with the customer
- Step 2 - Identify the separate performance obligations
- Step 3 - Determine the transaction price
- Step 4 - Allocate the transaction price to the performance obligations
- Step 5 - Recognise revenue when (or as) the entity satisfies a performance obligations.

Your company wants you to write a paper that discusses the first two steps of the five steps model of IFRS 15.

Required:

Write a paper that discusses the first two (2) steps of the five (5) steps model of revenue recognition of IFRS 15 '*Revenue from contracts with customers*'. (10 marks)

[Total: 20 Marks]

QUESTION THREE

(a) Basa Limited deals in groceries and hardware products. The company has thus two divisions, groceries' division and hardware's division. It was formed six (6) years ago by two Zambians who are the directors of the company. They have been responsible for the day to day running of the business. One of the directors made the following comments: "we have not seen the need to disclose the performance of each division. We have only been interested in the overall performance of the company; disclosing the performance of each division is a waste of time and does not add any value to our financial statements. Further, as far as I am concerned, there are no known criteria for identifying operating segments".

Required:

Discuss the comments made by the director of Basa limited, making reference to appropriate accounting standards. (10 marks)

(b) Lamasa Plc deals in motor vehicles. On 1 April 2015 it sold motor vehicles to Vasa Limited under the following terms:

(i) Lamasa Plc can require Vasa Limited to transfer the motor vehicles to another dealer without being compensated. Lamasa Plc has done this before with other dealers.

(ii) Vasa Limited may be charged a penalty equal to 5% of the current selling price of the motor vehicles in the event that it does not transfer the motor vehicles to another dealer.

(iii) Vasa Limited has no right to return the motor vehicles to Lamasa Plc. If Vasa Limited were to return any of the motor vehicles to Lamasa Plc it would be liable to a penalty equal to 30% of the current market price of motor vehicle returned.

(iv) Motor vehicles are priced based on their market price at the date of delivery and no price adjustments are to be made by Lamasa Plc to reflect current market price of motor vehicles.

Lamasa Plc is not sure of how to treat these motor vehicles in its financial statements for the year ended 31 March 2016.

Required:

Discuss how Lamasa Plc should treat the motor vehicles in its financial statements for the year ended 31 March 2016. (10 marks)

[Total: 20 Marks]

QUESTION FOUR

You work for Masa Chartered Accountants as one of the firm's financial consultants. Your client Kalale Plc has approached you for advice on the accounting treatment of the following transactions in its financial statements for the year ended 31 March 2016 in accordance with appropriate accounting standards. In addition, Kalale Plc needs to know the criteria that should be met for a financial liability to be carried at amortised cost in its financial statements.

Transaction One

Kalale Plc acquired 100,000 of the equity shares of Mala Plc on credit on 1 November 2015 at a cost of $120,000. No transaction costs were incurred. Kalale Plc has no intention of selling the equity shares. The acquired equity shares represents 30% of the total issued shares of Mala Plc. Kalale Plc however, did not have significant influence in Mala Plc.

Mala Plc's equity shares are only listed on the New York Stock Exchange. On 31 March 2016, the market price per equity share of Mala Plc on New York Stock Exchange was $1.40.

Kalale Plc paid for the shares in full on 30 April 2016.

Kalale Plc has not recorded the transaction in its financial statements.

The following exchange rates are relevant:

Date	K to $1
1 November 2015	12.000
31 March 2016	11.000
30 April 2016 (Forecast)	10.500

Transaction Two

Kalale Plc purchased a piece of plant on 1 April 2013 at a cost of K600,000. On 1 January 2014, the plant was revalued to K507,025. The plant was revalued again to K351,000 on 31 March 2015.

Depreciation is charged at an annual rate of 20% on straight line basis while capital allowances are claimed on straight line basis at a rate of 25%.

Kalale Plc wants advice on deferred tax effects of the transaction on its financial statements for the year ended 31 March 2016. Kalale Plc had a deferred tax liability of K18,000 at 31 March 2015. Kalale Plc is taxed at an annual rate of 30%.

Note: Assume that other assets and liabilities had no deferred tax effects in the year to 31 March 2016, the cost of K600,000 was correctly calculated and valuations were done by professional valuers.

Transaction Three

Kalale Plc acquired a piece of land on 1 April 2015. The purchase price of the land was K200,000. On the same date, Kalale Plc incurred legal fees of K10,000 in relation to transfer of ownership. Kalale Plc intends to keep the land and sell it when the market price increases substantially. The market price of land at 31 March 2016 was K225,000.

Kalale Plc does not know how to treat the land in its financial statements for the year ended 31 March 2016.

Required:

(a) Advise Kalale Plc on how the above transactions should be treated in its financial statements for the year ended 31 March 2016. (16 marks)

(b) Explain the criteria that should be met for a financial liability to be recognised at amortised cost in the financial statements of Kalale Plc. (4 marks)

[Total: 20 Marks]

QUESTION FIVE

You recently attended a workshop on various International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs). The Chief Executive Officer of your company wants you to write a report covering various accounting standards and accounting treatment of several transactions in accordance with applicable accounting standards.

Transaction One

Bala Plc leased out a machine that is used in the manufacture of soft drinks to Dasa Limited. The machine has an economic useful life of five (5) years. The terms of the lease agreement included the following:

(1) The lease will be for a period of three (3) years;
(2) Dasa Limited will be required to pay annual rentals of K40,000, K60,000 and K80,000 in the first year, second year and third year respectively;
(3) Lease rentals will be paid in arrears on 31 March of each year.
(4) Bala Plc will be responsible for insurance and maintenance of the machine. However, the cost will be borne by Dasa Limited. K10,000, K20,000 and K30,000 are included in rentals in (2) above for the first year, second year and third year respectively;

(5) The lease agreement will come into effect on 1 April 2015;
(6) Dasa Limited has no right to buy the machine at the end of the lease period.

Bala Plc incurred K5,000 on 1 April 2015 to negotiate and arrange the lease agreement with Dasa Limited. The machine was acquired on 31 March 2015 at cost of K700,000.

It is Bala Plc policy to depreciate machinery on straight line basis.

The transaction has not yet been recorded in the books of Bala Plc.

Note: Assume nil scrap value and that K700,000 includes all components of cost. Ignore present value of minimum lease payments.

Transaction Two

Bala Plc acquired a piece of machine on 1 June 2014 at a cost of K200,000. This cost is before taking into account trade discount of 5% that Bala Plc received on the same date. On 1 June 2015, the machine was revalued to K159,000.

During the year to 31 May 2016, there was a reduction in the use of the machine because of decline in demand for Bala Plc's products as a consequence of new entrants in the market. This prompted Bala Plc to review the machine for impairment. At 31 May 2016, the machine had a fair value less costs to sell of K86,000. Further, Bala Plc expects the machine to generate net inflows of K45, 000 in each of the last two years of its remaining economic useful life.

Bala Plc has a policy of transferring to retained earnings an amount representing realised revaluation surplus. Machines are depreciated using straight line method at an annual rate of 25%. Bala Plc uses an annual discount rate of 10%.

The machine is recorded in the financial statements of Bala Plc based on 31 May 2015 carrying value of K142,500.

Note: Assume the machine has a nil residual value at the end of its economic useful life.

Required

Write a report to the Chief Executive Officer that explains:

(a) The accounting treatment of operating leases in the books of the lessor. (4 marks)

(b) How the above transactions will be treated in the financial statements of Bala Plc for the year ended 31 May 2016. (16 marks)

Note: Include relevant calculations in your explanations.

[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

JUNE 2016: ADVANCED FINANCIAL REPORTING (P1)
SOLUTIONS

SOLUTION ONE

Maba Plc Group
Consolidated statement of financial position as at 31 March 2016

	K'000
Assets	
Non – current assets	
Property, plant and equipment 384+420+567+15W1+5W1 – 1W4+19pr	1,409
Goodwill **W1**	10
Investment in associate **W2**	124
	1,543
Current assets	
Inventory 55+45+35	135
Trade receivables 125+115+105	345
Cash and cash equivalents 65+75+85	225
	705
Total assets	**2,248**
Equity and liabilities	
Equity	
Equity shares of K0.80 each	400
Other components of equity **W5**	196.8
Retained earnings **W4**	203.7
	800.5
Non – controlling interests **W6**	325.5
Total equity	**1,126**
Liabilities	
Non – current liabilities 220+180+170 +20 **provision**	590
Current liabilities 255+145+132	532
Total liabilities	**1,122**
Total equity and liabilities	**2,248**

Workings

W1 – Goodwill

Sasa Plc	K'000	K'000	K'000
Consideration			337
NCI at acquisition 40% x 545,000			218
			555
FV of NAs at acquisition:			
Share capital		320	
Other components of equity		130	
Retained earnings		90	
FV adj. – Plant (bal. fig)		5	
			(545)
Goodwill			**10**

Zana Plc			
Consideration: Direct		79	
Indirect 60% x 260,000		156	
NCI at acquisition 38% x 415,000		157.7	
		392.7	
FV of NAs at acquisition:			
Share capital	240		
Other components of equity	100		
Retained earnings	60		
FV adj. – Land (bal. fig)	15		
		(415)	
Negative goodwill		**(22.3)**	

W2 – Investment in associate

	K'000
FV of retained interest	120
Group share of profit after tax 40% x 10	4
	124

W3 – Disposal of 60% interests in Nava Plc

	K'000	K000
Consideration received		180
FV of retained interests		120
		300
FV of NAs at disposal	290	
Goodwill 300 – 280	20	
		(310)
Loss on disposal		**(10)**

W4 – Retained earnings

	K'000
As per question – Maba Plc	130
Group share of post acquisition in:	
Sasa Plc 60% x (120 – 90 – 1 **See note below**)	17.4
Zana Plc 62% x (110 – 60)	31
Nava Limited 100% x (290 – 280)	10
Negative goodwill **W1**	22.3
Depreciation on capitalised provision 1/20 x 20	(1)
Share of Nava Limited profit after tax W2	4
Loss on disposal of Nava Limited W3	(10)
	203.7

Note:
Depreciation on FV adj. 1/5 x 5 = 1,000

W5 – Other components of equity

	K'000
As per question – Maba Plc	160
Group share of post acquisition in:	
Sasa Plc 60% x (150 – 130)	12
Zana Plc 62% x (140 – 100)	24.8
	196.8

W6 – Non – controlling interest

	K'000	K'000
In Sasa Plc		
At acquisition W1		218
Share of post acquisition:		
Other components of equity 40% x 20W3		8
Retained earnings 40% x 29W2		11.6
Share of investment in Zana Plc 40% x 260		(104)
		133.6
In Zana Plc		
At acquisition W1	157.7	
Share of post acquisition:		
Other components of equity 38% x 40W3	15.2	
Retained earnings 38% x 50W2	19	
		191.9
Total NCI		**325.5**

SOLUTION TWO

a) (i) ROCE = PBIT/CE = [84+42+54/(150+80+100] x 100% = 180/330
= 54.55%
EPS = PAT/Weighted average number of shares = 84/ (150/0.6) = 84/250 = **K0.34 per share**

(ii) ROCE = PBIT/CE = 180 – (80 – 10)/330 – 68**W** = 110/262 = **41.98%**
EPS = PAT/WANS = (84 – 70)/250 = **K0.06 per share**

Working – Net plan liability at 31 March 2016

	K'000
Net plan assets at 31 March 2015	(20)
Net expense	80
Net actuarial losses	8
Net plan liabilities at 31 March 2016	**68**

b) The following discusses the first two steps of IFRS 15 five steps model

Step 1: Identify the contract with the customer

A contract with a customer will be within the scope of IFRS 15 if all the following conditions are met:

- the contract has been approved by the parties to the contract;
- each party's rights in relation to the goods or services to be transferred can be identified;
- the payment terms for the goods or services to be transferred can be identified;
- the contract has commercial substance; and
- it is probable that the consideration to which the entity is entitled to in exchange for the goods or services will be collected.

If a contract with a customer does not yet meet all of the above criteria, the entity will continue to re-assess the contract going forward to determine whether it subsequently meets the above criteria. From that point, the entity will apply IFRS 15 to the contract.

The standard provides detailed guidance on how to account for approved contract modifications. If certain conditions are met, a contract modification will be accounted for as a separate contract with the customer. If not, it will be accounted for by modifying the accounting for the current contract with the customer. Whether the latter type of modification is accounted for prospectively or retrospectively depends on whether the remaining goods or services to be delivered after the modification are distinct from those delivered prior to the modification.

Step 2: Identify the performance obligations in the contract

At the inception of the contract, the entity should assess the goods or services that have been promised to the customer, and identify as a performance obligation:

- a good or service (or bundle of goods or services) that is distinct; or

- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A series of distinct goods or services is transferred to the customer in the same pattern if both of the following criteria are met:

- each distinct good or service in the series that the entity promises to transfer consecutively to the customer would be a performance obligation that is satisfied over time (see below); and
- a single method of measuring progress would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

A good or service is distinct if both of the following criteria are met:

- the customer can benefit from the good or services on its own or in conjunction with other readily available resources; and
- the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Factors for consideration as to whether a promise to transfer the good or service to the customer is separately identifiable include, but are not limited to:

- the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract.
- the good or service does not significantly modify or customise another good or service promised in the contract.
- the good or service is not highly interrelated with or highly dependent on other goods or services promised in the contract.

SOLUTION THREE

a) The comments made by one of the directors of Basa Limited suggest that he has not heard of IFRS 8 '*Operating Segments*'. IFRS 8 defines an operating segment as a component of an entity:
   - That engages in business activities from which it may earn revenues and incur expenses,
   - Whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
   - For which discrete financial information is available.

   The two divisions meet the definition of an operating segment. They do generate revenue and incur costs. Presumably, their performance is regularly assessed and financial information can easily be made available.

   IFRS 8 does provide for the criteria that must be met for an entity to report separate information about each operating segment. These include the following:

   i) Meeting the definition of an operating segment. This has already been explained; and
   ii) Segment total is 10% or more of total:

- Revenue (internal and external), or
- All segments not reporting a loss (or all segments in loss if greater), or
- Assets

Further, at least 75% of total external revenue must be reported by operating segments.

The said criteria imply that Basa Limited will have to calculate percentage contribution of each division to Basa Limited's total revenue, profit or loss and assets to establish their meeting of the second criterion. However, even if one of them does not meet the criterion, the directors may still show it separately if they believe information about the segment may be useful to users of financial information and that it only has two segments and only one threshold has to be met.

Basa Limited needs to disclose the following information about each operating segment in accordance with IFRS 8:

- Operating segment profit or loss
- Segment assets
- Segment liabilities

Basa Limited will derive the following benefits from providing information on each division:

- The entity's past performance will be better understood
- The entity's risks and returns may be better assessed
- More informed judgements may be made about the entity as a whole.

However, Basa Limited being a limited company owned and run by two directors, there may be no need for it to disclose the performance of each division. Further, it may prove time consuming and costly to analyse the information and attribute it to each division. The company presumably has a centralised purchasing system and may have one sales point for all its products.

b) The treatment of the motor vehicles in the financial statements of Lamasa Plc for the year to 31 March 2016 will depend on whether Lamasa Plc has transferred the risks and rewards associated with ownership of the motor vehicles to Vasa Limited or not. The first two terms of the sales, Lamasa Plc having the right to require Vasa Limited to transfer motor vehicles to another dealer and Vasa Limited being liable to a penalty for failure to transfer the motor vehicles suggest that the vehicles are still owned by Lamasa Plc. However, Vasa Limited has no right to return the motor vehicles to Lamasa and doing so attracts a substantial penalty at a rate of 30%. Moreover, Vasa Limited is charged a price based on delivery date and not on the date they are sold to Vasa Limited's customers. This implies that the risk of reduction in the market prices of motor vehicles is borne by Vasa Limited. These suggest that motor vehicles are owned by Vasa Limited at delivery.

Conclusion

Overall, Lamasa Plc still has control over the motor vehicles as it has required other dealers to transfer motor vehicles without compensating them. Lamasa Plc should therefore, recognise the motor vehicles as part of its inventories at 31 March 2016 subject to the provisions of IAS 2 '*Inventories*'.

SOLUTION FOUR

a) Transaction One

The investment in equity shares of Mala Plc should be classified as financial assets at fair value through other comprehensive income. The shares will initially be recognised at their fair value of K1,440,000 ($120,000 x K12) at 1 November 2015. A liability of K1,440,000 will also be recognised at 1 November 2015. The financial asset and its related liability should be re-measured at 31 March 2016. The financial asset will be increased to K1,680,000 (100,000 shares x $1.4/share x K12/$1). This results in an increase of K240,000 (1,680,000 – 1,440,000) which will be taken to other comprehensive income. The liability will be re-measured at 31 March 2016 to K1,320,000 ($120,000 x K11). This results in an exchange gain of K120,000 which will be recognised in the statement of profit or loss for the year ended 31 March 2016.

Transaction Two

Kalale Plc has to compute deferred tax liability or asset at 31 March 2016 in order to calculate increase or decrease in deferred tax liability or asset to be taken to the statement of profit or loss as part of the income tax expense for the year to 31 March 2016.

The plant has a carrying value and a tax base of K234,000 [351,000 – (351,000/3)] and K150,000[600,000 – (25% x 600,000 x 3 years)] respectively at 31 March 2016. This results in taxable temporary difference of K84,000 (234,000 – 150,000) and deferred tax liability of K25,200 (30% x 84,000) at 31 March 2016.

Kalale Plc should recognise deferred tax liability of K25,200 under non – current liabilities in its statement of financial position at 31 March 2016. An increase in deferred tax of K7,200 (25,200 – 18,000) should be included in income tax expense for the year to 31 March 2016.

Transaction Three

IAS 40 '*Investment property*' provides for the criteria that have to be met for an item of property to be classified as investment property. The property must be held to earn rentals or for capital appreciation. It excludes property held for:

- Sale in the ordinary course of business or
- Use in the production or supply of goods or services or for administrative purposes.

In the case of Kalale Plc's land, it should not be classified as investment property as it is held for sale and not for capital appreciation. Its value will be realised through a sale. Further, it cannot be classified as held for sale as Kalale Plc is not ready to sell it immediately. This is because Kalale Plc has not defined what will amount to substantial increase in market value of land and it has not made any efforts to locate the buyer of the land.

Kalale Plc should carry the land at its cost of K210,000 (200,000 + 10,000) in its statement of financial position as at 31 March 2016. It can revalue the land to K225,000 at 31 March 2016 and recognise revaluation gain of K15,000 (225,000 – 210,000) in other comprehensive income for the year ended 31 March 2016 if it uses revaluation model of IAS 16'*Property, plant and equipment*'.

b) Financial liability recognised at amortised cost.

This is a restrictive classification as it only applies to debt instruments and not to equity instruments. Equity instruments may be classified as either at fair value through profit or loss or at fair value through other comprehensive income. The debt instrument should not be held purely for trading. That is, an entity should not acquire it for the sole purpose of realising its value through selling.

Further, 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.

SOLUTION FIVE

Report

To: Chief Executive Officer
From: Accountant
Date:

Subject: Operating Leases and Accounting treatment of Bala Plc's transactions for the year ended 31 March 2016.

1.0 Introduction

The report covers the accounting treatment of operating leases in the books of the lessor and treatment of the two transactions in the books of Bala Plc for the year to 31 May 2016.

2.0 Accounting treatment

2.1 Operating leases in lessor's books (a)

The lessor will continue recognising the leased asset under non – current assets subject to depreciation and impairment review. Further, the lessor will recognise lease rentals provided for in the lease agreement in its statement of profit or loss on straight line basis or on any other basis deemed appropriate. The rentals will be recognised as income. The difference between the amount recognised as income and amount paid will be shown in the statement of financial position as either a current liability (accrual) or a current asset (prepayment).

2.2 Transaction One (b)

This is on IAS 17 '*Leases*'. The lease period of 3 years is not substantially equal to the economic useful life of the machine of 5 years. In addition, Dasa Limited has no right to buy the machine at the end of the lease period. These show that Bala Plc has leased out the machine under an operating lease despite Dasa Limited being responsible for insurance and maintenance of the machine. Bala Plc should show the machine in its statement of financial position as at 31 March 2016 at a carrying value of K564,000 **W1**. This is based on purchase cost of the machine of K700,000 and capitalised lease arrangement costs of K5,000 spread over the economic useful life of the machine of 5 years. Depreciation charge

of K141,000 **W1** will be expensed to the statement of profit or loss for the year to 31 March 2016. Lease rentals should be recognised as income in the statement of profit or loss for the year ended 31 March 2016 based on straight line method. This should exclude amounts relating to insurance and maintenance costs which will be recognised as deferred income under current liabilities in the statement of financial position as at 31 March 2016 and only transferred to the statement of profit or loss when the cost has been incurred by Bala Plc. Bala Plc should therefore recognise lease rental income of K40,000 **W2**. K10,000 (40,000 **W2** - 30,000) will be shown under current liabilities as an accrual and K10,000 relating to insurance and maintenance will also be shown under current liabilities as deferred income or taken to the statement of profit or loss if the related expense has already been incurred by Bala Plc.

2.3 Transaction Two (b)

This is on IASs 16 '*Property, plant and equipment*' and 36'*Impairment of assets*'. The machine should have been recorded in the financial statements of Bala Plc after taking into account effects of revaluation and impairments. At 1 June 2015, the machine should be revalued to K159,000. This would give rise to revaluation surplus of K16,500 **W3**. Transfer to retained earnings of K5,500 **W4** representing excess depreciation would increase retained earnings by the same amount and reduced revaluation surplus to K11,000 **W4**. Bala Plc should recognise depreciation charge for the year to 31 May 2016 of K53,000 **W3**. This should be based on the revalued amount and remaining useful economic life of 3 years. At 31 May 2016, the carrying value of the machine of K106,000 **W3** should be compared with its recoverable amount of K86,000, the higher of fair value less costs to sell of K86,000 and value in use of the machine of K78,120**W5,** to determine any impairment loss. The carrying value of the machine is more than its recoverable by K20,000 (106,000 – 86,000). This represents an impairment loss. The impairment loss should reduce the carrying value of the machine to its recoverable amount of K86,000. K11,000 of the impairment loss should reverse remaining revaluation surplus and balance, K9,000 to be expensed to the statement of profit or loss for the year ended 31 May 2016.

3.0 Conclusion

Do not hesitate to contact me if you have any queries on issues covered in the report.

Accountant

Workings

W1 – Calculation of carrying value of the machine at 31 March 2016

	K'000
Cost of machine	700
Lease arrangement cost	5
Total	**705**
Depreciation 1/5 x 705	(141)
Carrying amount	**564**

W2 – Calculation of lease rentals

		K'000
Yr 1	Rental (40,000 – 10,000)	30
Yr 2	Rental (60,000 – 20,000)	40
Yr 3	rental (80,000 – 30,000)	50
	Total	120
	Annual rental 120/3yrs	**40**

W3 – Machine

	K'000
Carrying value at 31 May 2015	142.5
Revaluation surplus (bal. fig)	16.5
Revalued amount at 1 June 2015	159
Deptn to 31 May 2016 (1/3 x 159)	(53)
Carrying value at 31 May 2016	106

W4 – Revaluation Reserve

	K'000
Surplus at 31 May 2015 (W3)	16.5
Transfer to retained earnings (1/3 x 16.5)	(5.5)
Balance at 31 May 2016	11

W5 – Value in Use

	K'000
K45,000 p.a (2yrs) x 1.736 (AF@10%,2yrs)	78.12

END OF SOLUTIONS