



CHARTERED ACCOUNTANTS EXAMINATIONS

PROFESSIONAL LEVEL

P1: ADVANCED FINANCIAL REPORTING

MONDAY 14 DECEMBER 2015

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 are the draft statements of financial position of Meta Plc, Neta Plc and Leta Plc as at 30th November 2014:

	Meta Plc K'million	Neta Plc K'million	Leta Plc US\$'million
Assets			
Non-current			
Property, plant and equipment	2,890	1,080	256
Development cost	350	nil	nil
Financial assets	<u>1,014</u>	<u>68</u>	<u>34</u>
	<u>4,254</u>	<u>1,148</u>	<u>290</u>
Current			
Inventory	670	470	50
Trade receivables	430	165	38
Other receivables	737	317	55
Cash & cash equivalents	<u>536</u>	<u>236</u>	<u>40</u>
	<u>2,373</u>	<u>1,188</u>	<u>183</u>
Total assets	<u>6,627</u>	<u>2,336</u>	<u>473</u>
Equity and liabilities			
Equity			
Equity shares	1,850	520	72
Other components of equity	600	195	nil
Retained earnings	<u>950</u>	<u>308</u>	<u>139</u>
Total equity	<u>3,400</u>	<u>1,023</u>	<u>211</u>
Liabilities			
Non-current			
Deferred tax	870	440	60
13% loan notes	<u>1,081</u>	<u>nil</u>	<u>nil</u>
	<u>1,951</u>	<u>440</u>	<u>60</u>
Current			
Trade payables	690	370	80

Other payables	156	123	57
Taxation	<u>430</u>	<u>380</u>	<u>65</u>
	<u>1,276</u>	<u>873</u>	<u>202</u>
Total liabilities	<u>3,227</u>	<u>1,313</u>	<u>262</u>
Total equity and liabilities	<u>6,627</u>	<u>2,336</u>	<u>473</u>

Additional information

1. Meta Plc acquired 60% of K1.00 equity shares of Neta Plc on 1st December 2012 for a share exchange of 3 shares in Meta Plc for every 4 shares in Neta Plc. The fair values of Neta's and Meta's equity shares at 1st December 2012 were K1.25 and K2.50 respectively.

The fair value of net assets of Neta Plc at 1st December 2012 stood at K820 million. The other components of equity and retained earnings were K85 million and K190 million respectively on the acquisition date. The increase in fair value relates to an item of plant with an economic useful life of five years at the date of acquisition. The fair value of non-controlling interest on acquisition date was K260 million.

Neta Plc has neither issued additional equity shares nor incorporated increase in fair value of net assets in its financial statements since acquisition date.

2. On 30th November 2013, Meta Plc acquired additional 20% of Neta Plc's total equity shares for a cash consideration of K130 million.

Neta Plc's profits for the years ending 30th November 2013 and 30th November 2014, before incorporating the effects of fair value adjustments in its financial statements, were K42 million and K76 million respectively. The other components of equity were K45 million for the year to 30th November 2013 and K65 million for the year ending 30th November 2014.

Note: Only the cash consideration has been accounted for in the above draft statements of financial position.

3. Meta Plc acquired 75% of \$1.00 equity shares of Leta Plc on 1st December 2013 for a cash consideration of K855 million. The fair value of net assets at the date of acquisition was \$180 million. Retained earnings were \$89 million at 1st December 2013. There were no other components of equity on that date. The increase in the fair value of net assets relates to non-depreciable land.

The fair value of non-controlling interest was \$47.5 million at 1st December 2013.

Leta Plc has neither issued additional equity shares nor incorporated the increase in fair value of net assets since acquisition date.

4. Meta Plc sold a piece of land on credit to Leta Plc for K5.22 million on 1st October 2014. The land had a carrying value of K1 million at the date of disposal. Leta Plc paid the amount due on 10th December 2014.

The transaction is reflected in the above statements of financial position. However, Leta Plc used the exchange rate at transaction date to record it in its books.

5. The following exchange rates are relevant:

Kwacha to US\$

At 1 st December 2013	K6.000
At 1 st October 2014	K5.800
At 30 th November 2014	K6.250
Average rate for the year to 30 th November 2014	K6.100
At 10 th December 2014	K6.300

6. Investments in Leta Plc and Neta Plc are classified as **financial assets at fair value through other comprehensive income in accordance with IFRS 9**. The fair values of investments in Neta Plc, cash consideration only, and in Leta Plc at 30th November 2014 were K137 million and K877 million respectively.
7. Development expenditure qualifies for capitalisation and the project was completed on 30th November 2014.
8. Goodwill in Neta Plc was impaired by K4 million and K3 million as at 30th November 2013 and 30th November 2014 respectively. However, goodwill in Leta Plc had not been impaired since the date of acquisition.
9. It is group policy to value goodwill based on the full goodwill method.
10. Unless otherwise stated, assume all profits and losses accrue evenly throughout the year.
11. None of the companies paid dividends for the periods to 30th November 2013 and 30th November 2014.

Required:

Prepare a consolidated statement of financial position for Meta group as at 30th November 2014 in accordance with International Financial Reporting Standards and International Accounting Standards.

[Total: 40 Marks]

QUESTION TWO

- (a) Shalom Ltd prepares financial statements to 31 March each year. On 1st April 2013, Shalom Ltd purchased equipment for K 4,800,000 with a useful economic life of 5 years. Shalom Ltd depreciates equipment on a straight line basis.

The company does not have any other Non-Current Assets other than the equipment purchased on 1 April 2013.

The tax allowances relating to this asset are granted by the Zambia Revenue Authority at an annual rate of 25% using straight line method.

Income tax rate applicable to Shalom Ltd is 30% per annum.

Required:

- (i) Explain why permanent difference between accounting profits and taxable profits do not have deferred tax consequences. (2 marks)
- (ii) Prepare the statement of profit or loss and statement of Financial Position extracts for the year to 31st March 2015, taking into account IAS 12 '*Income tax*' requirements. (7 marks)

Note: Assume estimated current tax for the year to 31st March 2015 is K24,000.

- (b) Naca Plc incurred development expenditure amounting to K150,000 and K200,000 in the year ending 30 November 2013 and 30 November 2014 respectively on the new product, 'Foodies', that the company has developed for two years now. The product will be ready for sale on 31st December 2014. The figure shown under non-current assets in the statement of financial position as at 31st December 2014 represents the total development expenditure to date of K350,000.

The directors of Naca Plc, at 30th November 2013, estimated that 'Foodies' would generate total revenue of K400,000 over its economic life. They, at 30th November 2014, revised the figure to K500,000 owing to positive developments in the product's market.

Estimates of costs to completion of product development are as follows:

At 30 November 2013	K270,000
At 30 November 2014	K70,000

Required:

Explain the appropriate adjustments required to correctly account for the development expenditure in the financial statements of Naca Plc for the year to 30 November 2014.

(6 marks)

- (c) Namana Limited borrowed K800,000 on 1st January 2014 from Babana Bank. The loan attracts interest rate of 10% per annum. The loan was for the construction of its office block.

Construction commenced on 1st April 2014 and is likely to be completed on 31st March 2016. On 30th September 2014, construction works were suspended because of striking construction workers. However, construction works resumed on 1st January 2015.

Note: Interest for the year to 31st December 2014 has been paid.

Required

Explain the accounting treatment of interest cost in the financial statements of Namana Limited for the year to 31st December 2014.

(5 marks)

[Total: 20 Marks]

QUESTION THREE

- (a) Banana Plc purchased a four year non-convertible loan note on 1st June 2014 for K100,000. The loan has a coupon rate of 10% per annum and an annual effective interest rate of 12%. The difference between the two interest rates is due to a premium of K10,000 receivable at loan maturity.

The interest for the year to 31st May 2015 was received on 30th May 2015.

This kind of loan has an annual market interest rate of 8%.

Required:

Explain the accounting treatment of the loan note in the financial statements of Banana Plc for the year to 31st May 2015 if it were classified as follows:

- | | | |
|------|--|-----------|
| (i) | Financial asset at amortised cost | (4 marks) |
| (ii) | Financial asset at Fair value through profit or loss | (6 marks) |

- (b) IFRS 2 '*Share based payments*' covers mainly accounting for cash settled and equity settled transactions. Share based payments are introduced as ways to motivate employees and enhance the overall performance of the company.

Bacana Ltd decided to introduce a performance related scheme effective 1st June 2014. The terms of the scheme were as follows:

- 20 of its employees would be entitled to 1,000 equity shares each.
- The company would compulsorily give each of the employees cash for sixty percentage of their entitled shares. The cash would be based on the market value of those shares at 31st May 2017.
- The remainder of employees' entitled shares would be issued to employees on 1st June 2017.
- Only employees who would be with the company up to 31st May 2017 would be entitled to cash and shares under the scheme.

The company expected one employee to leave the company by 31st May 2017. During the year to 31st May 2015, one employee left the company. However, the directors of Bacana Ltd do not expect another employee to leave the company by 31st May 2017.

The following information is relevant

Date	Market value per share
1 st June 2014	K15.00
31 st May 2015	K16.00
31 st May 2016	K17.00 Forecast
31 st May 2017	K20.00 Forecast

Required:

- Explain how cash settled and equity settled transactions are accounted for in the financial statements of an entity. (4 marks)
- Explain how the above transaction would be accounted for in the financial statements of Bacana Ltd for the year to 31st May 2015. (6 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) Transaction One

Cada Ltd has been in business of providing guarding and other security services to various small and medium sized businesses. Recently, the company has been experiencing stiff competition. This has affected its cash flows adversely.

On 1st March 2015 Cada Ltd decided to sell some of its trade receivables to Funda Bank. The value of trade receivables sold was K300,000.

The terms of the sale were that:

- (i) Funda Bank would pay Cada Ltd 85% of the value of trade receivables on 1st March 2015. This was fulfilled by the bank on the agreed date.
- (ii) Cada Ltd would be required to pay an amount equal to the value of trade receivables to Funda Bank in the event that the trade receivables failed to pay by 1st June 2015.
- (iii) Insurance of trade receivables would be done by Cada Ltd.

Funda bank had not received any payment from purchased trade receivables by 31st May 2015.

Required:

Explain the accounting treatment of above transaction in the financial statements of Cada Ltd for the year to 31st May 2015. (8 marks)

(b) Transaction Two

The following information relates to Daca Ltd for the year to 31st May 2015.

Statement of profit or loss (extract) for the year to 31st May 2015

	K'000
Profit before interest and tax	60
Finance cost	12
Taxation	16

Statement of financial position (extract) as at 31st May 2015

	K'000
Equity	
Equity shares of K0.50 each	100
Share premium	85
Retained earnings	40

Additional information

- (i) On 1st September 2014, Daca Ltd issued 50,000 equity shares for K2.00 each. The price represents the market value of Daca Ltd equity shares on that date.
- (ii) On 1st December 2014, Daca Ltd made a bonus issue of 15,000 equity shares to its shareholders at par. It utilised its share premium for this issue.
- (iii) The company has offered 10 of its directors an option to buy 1,000 equity shares each at a price of K1.80 each. The option to buy shares will vest on 1st June 2016. The company's shares have a market value of K2.00 per share.
- (iv) Daca Ltd has K200,000 10% convertible loan. The loan will be converted into shares on 1st June 2018. Terms of conversion are 200 shares for every K1,000 convertible loan.

- (v) Shares issued in (i) and (ii) above have been accounted for correctly.
- (vi) Income tax rate of 30% per annum applies to Daka Ltd.

Required:

- (i) Describe how the basic and diluted earnings per share are calculated. (4 marks)
- (ii) Explain the significance of calculating diluted earnings per share. (1 mark)
- (iii) Calculate the basic and diluted earnings per share of Daka Ltd for the year to 31st May 2015. (7 marks)

[Total: 20 Marks]

QUESTION FIVE

- (a) Thaba Limited was formed on 30th November 2013. On 1st January 2014 it acquired its first item of plant for K400,000. The plant will be used in the manufacture of a soft drink called 'Nicee'. Being a new company, it has not yet decided on the policy to adopt regarding subsequent measurement of property, plant and equipment.

The director of Thaba Limited has read that there are two methods that are provided for in IAS 16 '*Property, plant and equipment*' as regards to subsequent measurement of property, plant and equipment. However, he does not know the difference between the two methods with respect to how and when they are applied, and how they affect the financial statements.

Required

Describe cost model and revaluation model as subsequent measurement methods of valuing property, plant and equipment, in accordance with IAS 16. (10 marks)

- (b) IFRS 15 '*Revenue from Contracts with Customers*' specifies how and when an entity will recognise revenue as well as requiring such entities to provide users of financial statements with more informative relevant disclosures.

The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework.

Required:

Outline IFRS 15 '*Revenue from Contracts with Customers*' five step model framework of revenue recognition. (10 marks)

[Total: 20 Marks]

END OF PAPER

P1: ADVANCED FINANCIAL REPORTING

SUGGESTED SOLUTIONS

DECEMBER 2015 EXAMINATIONS

SOLUTION ONE

Meta Group

Consolidated statement of financial position as at 30th November 2014

K'million

Assets

Non-current

Property, plant & equipment $2,890+1,080+15W2+1,718.75W4-4.22W3$	5,699.53
Financial assets $68+212.5W4$	280.50
Development cost	350.00
Goodwill W1	<u>80.50</u>
	<u>6,410.53</u>

Current

Inventory $670+470+312.5W4$	1,452.50
Trade receivables $430+165+237.5W4$	832.50
Other receivables $737+317+343.75W4 - 5.22W3$	1,392.53
Cash and cash equivalents $536+236+250W4$	<u>1,022.00</u>
	<u>4,699.53</u>

Total assets

11,110.06

Equity and liabilities

Equity

Equity share of K1.00 each $1,850+234W8$	2,084.00
Other components of equity W7	1,016.60
Retained earnings W5	<u>1,290.26</u>
	<u>4,390.86</u>
Non-controlling interest W9	<u>547.29</u>
Total equity	<u>4,938.15</u>

Liabilities

Non-current

Deferred tax $870+440+375W4$	1,685.00
13% loan notes	<u>1,081.00</u>
	<u>2,766.00</u>

Current

Trade payables $690+370+500W4$	1,560.00
Other payables $156+123+355.88W4 - 5.22W3$	629.66
Taxation $430+380+406.25W4$	<u>1,216.25</u>
	<u>3,405.91</u>

Total liabilities	<u>6,171.91</u>
Total equity and liabilities	<u>11,110.06</u>

Workings

W1 Goodwill

<u>Neta Plc</u>	\$'million	K'million
Consideration:		
Share exchange $\{3/4 \times (60\% \times 520)\} \times K2.50$		585
FV of NCI		260
FV of net assets at acquisition		<u>(820)</u>
Goodwill		25
Impairment K4m+K3m		<u>(7)</u>
		<u>18</u>
 <u>Leta Plc</u>		
Consideration K855m/K6.00/\$	142.5	
FV of NCI	47.5	
FV of net assets at acquisition	<u>(180)</u>	
Goodwill	<u>10</u>	
Translated at 1 st December 2013 \$10 x K6/\$		60
Exchange gain (bal. fig)		<u>2.5</u>
Translated at 30 th November 2014 \$10 x K6.25/\$		<u>62.5</u>
Total net goodwill K18m + K62.5m		<u>80.5</u>

W2 Fair value adjustments

<u>Neta Plc</u>	\$'million	K'million
Book value of net assets at acquisition:		
Equity share capital		520
Other components of equity		85
Retained earnings		<u>190</u>
		795
Fair value of net assets at acquisition		<u>820</u>
Fair value adjustment – Plant		25
Dept'n on FV adjustment $2/5 \times K25m$		<u>(10)</u>
		<u>15</u>

Leta Plc

Book value of net assets acquisition:

Equity share capital	72
Other components of equity	nil
Retained earnings	<u>89</u>
	161
Fair value of net assets at acquisition	<u>180</u>
Fair value adjustment	<u>19</u>

W3 Disposal of land

Calculation of profit on disposal

	K'million
Disposal proceeds (owing)	5.22
Less: carrying value at disposal	<u>(1)</u>
Profit on disposal	<u>4.22</u>

K5.22m included in current assets of Meta Plc will be cancelled with that shown under current liabilities in the books of Leta Plc. K4.22m being unrealised profit should be reversed.

Leta Plc will recognise an exchange gain of \$0.06m in its books.

Payable at 1 st October 2014 K5.22m/K5.8/\$	\$0.9m
Payable at 30 th November 2014 K5.22/K6.25/\$	<u>\$0.84m</u>
Exchange gain	<u>\$0.06m</u>

W4 Leta Plc

Statement of financial position as at 30th November 2014 translation schedule

	\$'million	Adjustment \$'million	Rate	K'million
Assets				
Non-current				
Property, plant & equipment	256	+ 19W2	x 6.25	1,718.75
Financial assets	34		x 6.25	212.50
Current				
Inventory	50		x 6.25	312.50
Trade receivables	38		x 6.25	237.50
Other receivables	55		x 6.25	343.75
Cash & cash equivalents	<u>40</u>		x 6.25	<u>250.00</u>
Total assets	<u>473</u>			<u>3,075.00</u>

Equity

Equity shares	72		x 6.00	432.00
Other reserves	nil	+19W2	x 6.00	114.00
Retained earnings – Pre	89		x 6.00	534.00
Post	<u>50</u>	+0.06W3	Bal.fig	<u>357.87</u>
Total equity	<u>211</u>			<u>1,437.87</u>
Liabilities				
Deferred tax	60		x 6.25	375.00
Trade payables	80		x 6.25	500.00
Other payables	57	- 0.06W3	x 6.25	355.88
Taxation	<u>65</u>		x 6.25	<u>406.25</u>
Total liabilities	<u>262</u>			<u>1,637.13</u>
Total equity and liabilities	<u>473</u>			<u>3,075.00</u>

W5 Retained earnings

	K'million
As per question – Meta Plc	950.00
Group share in:	
Leta Plc 75% x 357.87W4	268.40
Neta Plc {60% x (42 – 5)} + {80% x (76 – 5)}	79.00
Unrealised profit on disposal of land W3	(4.22)
Exchange gain on goodwill 75% x 2.5W1	1.88
Goodwill impairment (60% x 4) + (80% x 3)	<u>(4.80)</u>
	<u>1,290.26</u>

W6 Movement on equity – 20% additional shareholding in Neta Plc

	K'million
Fv of NCI at 1 st December 2012	260.00
Share of retained earnings upto 30 th November 2013	
40% x (42 – 5)	14.80
Share of OCE upto 30 th November 2013 40% x 45	18.00
Goodwill impairment at 30 th November 2013 40% x 4	<u>(1.60)</u>
	<u>291.20</u>
Decrease in NCI 20/40 x 291.12	145.60
Consideration paid	<u>130.00</u>
Positive movement transferred to OCE	<u>15.60</u>

W7 Other components of equity

	K'million
As per question – Meta Plc	600.00
Group share in:	
Neta Plc (60% x 45) + (80% x 65)	79.00

Share premium W8	351.00
Movement on equity W6	15.60
Reversal of gains in investment in:	
Neta Plc 137 – 130	(7.00)
Leta Plc 877 – 855	<u>(22.00)</u>
	<u>1,016.60</u>

W8 Share exchange

K'million

Equity share capital $\{ \frac{3}{4} \times (60\% \times 520) \} \times K1.00$	234
Share premium $\{ \frac{3}{4} \times (60\% \times 520) \times (K2.5 - K1) \}$	351

W9 Non – controlling interest

K'million

Neta Plc

NCI immediately before acquisition of further 20% W6	291.20
Decrease in NCI W6	(145.60)
Share of retained profit to 30 th November 2014:	
20% x (76 – 5)	14.20
Share of OCE to 30 th November 2014:	
20% x 65	13.00
Goodwill impairment at 30 th November 2014 20% x 3	<u>(0.60)</u>
	<u>172.20</u>

Leta Plc

FV at acquisition \$47.5m x K6.00/\$	285.00
share of post-acquisition retained earnings 25% x 357.87W4	89.47
Exchange gain on goodwill 25% x 2.5W1	<u>0.62</u>
	<u>375.09</u>
Total	<u>547.29</u>

SOLUTION TWO

a)

- i) IAS 12 Income taxes define deferred tax as the estimated future tax consequences of transactions and events recognised in the financial statements of the current and previous periods.

The amount of current tax payable by an entity for an accounting period depends upon the entity's taxable profit for that period. However, this taxable profit will often be different from the profit shown in the financial statements (the accounting profit). Some of the income shown in the financial statements may not be chargeable to tax

and similarly, some of the expenses shown in the financial statements may not be deductible for tax purposes. Permanent differences are one-off differences between accounting and taxable profits caused by certain items not being taxable or allowable, and therefore only impact the tax computation of one period (the period when the event or transaction occurs). Permanent differences therefore do not have a deferred tax consequence

ii) **Taking deferred tax into account**

Statement of profit or loss Extracts

	2015
	K'000
Income tax (24,000+72,000)	90
Depreciation expense	960

Statement of Financial Position extracts

2015
K'000

Non-Current Assets

Property, Plant and Equipment 2,880

Non-Current Liabilities:

Deferred Tax 144

Current Liabilities

Current tax 24

Workings

Deferred tax calculation

	Carrying value		Tax base
	2014		2014
	K'000	K'000	K'000
Cost	4,800		4,800
Less: Depn/CA	<u>(960)</u>		<u>(1,200)</u>
CV/TB	3,840		3,600
Taxable TD (3,840 – 3,600)		<u>240</u>	
Deferred Tax liability @ 30%		72	

	Carrying value		Tax base
	2015		2015
	K'000	K'000	K'000
Cost	4,800		4,800
Less: Depn/CA	<u>(1,920)</u>		<u>(2,400)</u>
CV/TB	2,880		2,400
Taxable TD (2,880 – 2,400)		<u>480</u>	
Deferred Tax liability @ 30%		<u>144</u>	
Increase in deferred tax 144 – 72		72	

b) Development cost

Establishing the viability of 'Goodies'

	At 30 th November	
	2013	2014
	K'000	K'000
Expected revenue	400	500
Expected total costs (150+270): (200+70)	<u>(420)</u>	<u>(270)</u>
Profit / (loss)	<u>(20)</u>	<u>230</u>

The figures show that 'Goodies' were not viable at 30th November 2013 but at 30th November 2014. Therefore, the K150,000 development cost incurred and capitalised in 2013 should be reversed. Thus, a prior year adjustment has to be made by adjusting opening retained earnings for the year 30 November 2014. The K200,000 incurred in 2014 should be capitalised in 2014. The company should reduce development expenditure included in non-current assets by K150,000.

The capitalised development expenditure will not be amortised in the year to 30 November 2014 as development is its taking place.

c) IAS 23' *Borrowing Costs*' provides for when capitalisation of borrowing costs should commence and cease. Capitalisation starts when

- Activities directly related to construction of the qualifying asset have commenced
- Expenditure on an asset has been incurred.
- Interest costs are being incurred

However, capitalisation will cease mainly when activities directly related to construction of asset have

- ceased
- completed
- Suspended or
- Asset is ready for use

In the case of Namana Limited, the total interest for the year to 31st December amounted to K80,000 (10% x K800,000). K40,000 (6/12 x K80,000) should be capitalised as it was incurred when activities relating to construction of office block were taking place. However, K40,000 (6/12 x K80,000) should be expensed as it relates to the period when construction had not started, January 2014 to 31st March

2014, and when activities relating to construction had been abandoned, 1st October 2014 to 31st December 2014.

SOLUTION THREE

a) Non-convertible loan note

IFRS 9 '*Financial Instruments*' provides for two classifications for a debt instrument, fair value through profit or loss and amortised cost.

i) Amortised cost

This applies mainly to a debt instrument which meets two tests, business model and cash flow tests.

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.

Under amortised cost, the loan would be shown under non-current assets at a value of K102,000 **W2**. K12,000 would be recognised as income in the statement of profit or loss for the year ended 31st May 2015.

ii) Fair value through profit or loss

This classification is applicable to a debt instrument which held for trading. It also applies to derivative instruments. Further, the non-convertible loan would be classified at fair value through profit or loss if it failed the two tests. Otherwise it would be classified at amortised cost.

Under fair value through profit or loss it would be shown at a fair value of K113,110 **W1**. Decrease in fair value of K860 (113,970 – 113,110) **W1** would be recognised in the statement of profit or loss for the year to 31st May 2015.

Workings

W1 Fair value of loan note at 31st May 2015

	K	DF@8%	K
31 st May 2016 Interest @10%	10,000	0.926	9,260
31 st May 2017 Interest @10%	10,000	0.857	8,570

31 st May 2018 Interest @10%	10,000	0.794	7,940
31 st May 2018 Repayment	110,000	0.794	<u>87,340</u>
			<u>113,110</u>

Fair value of loan note at 1st June 2014

	K	DF@8%	K
31 st May 2015 Interest @10%	10,000	0.926	9,260
31 st May 2016 Interest @10%	10,000	0.857	8,570
31 st May 2017 Interest @10%	10,000	0.794	7,940
31 st May 2018 Interest @10%	10,000	0.735	7,350
31 st May 2018 Repayment	110,000	0.735	<u>80,850</u>
			<u>113,970</u>

W2 Loan note at amortised cost

Y/E	Opening Bal	<u>Eff.int@12%</u>	Inter @10%	Closing Bal.
31 st May	K	K	K	K
2015	100,000	12,000	(10,000)	102,000

b) (i) Cash settled and equity settled transactions

Cash settled transactions are recognised in the statement of financial position under liabilities and the movements in liability amount taken to statement of profit or loss. The liability is valued based on the cash expected to be paid out whose basis the current market value of each option.

The equity settled transaction on the other hand is recognised under equity and movements the value is taken to statement of profit or loss and other comprehensive income under expenses. The equity settled transactions is valued based on shares expected to vest using market value of each option at grant date.

Where shares are issued in exchange for an asset e.g. a building or inventories, and the entity cannot reliably measure the fair value of the shares, then the fair value of asset acquired should be used to value the issued shares.

(ii) The performance related scheme being offered by Bacana Ltd has both cash settled transaction and equity settled. The cash settled transaction should be valued based on reporting date market price per share and the number of shares that are expected to be issued to employees. Alternatively, the equity part of the scheme has to be valued based on the market price per share at grant date and the number shares that are expected to vest.

Bacana Ltd will therefore, recognise total expense of K98,800 (60,800W1+38,000W2) in its statement of profit or loss and other comprehensive income for the year ended 31st May 2015. In addition, a liability of K60,800W1 and an equity of K38,000 will be recognised in the statement of financial position as at 31st May 2015 in respect of cash settled transaction and equity settled transaction respectively.

Workings

W1 Cash settled transaction

	Liability K	Expense K
$60\% \times 1,000\text{shares} \times (20 - 1) \times K16 \times 1/3$	60,800	60,800

W2 Equity settled transaction

	Equity K	Expense K
$40\% \times 1,000\text{shares} \times (20 - 1) \times K15 \times 1/3$	38,000	38,000

SOLUTION FOUR

Transaction One

The treatment of this transaction in the books of Cada Ltd is dependent on whether the risks and rewards of ownership associated with trade receivables have been transferred to Funda bank or are still with Cada Ltd. It is therefore important to establish if a sale of trade receivables has taken place.

Looking at the terms of the sale, Cada Ltd is required to insure trade receivables and pay Funda bank an amount equal to the carrying value of trade receivables in the event that trade receivables failed to pay the amount owed. These two terms show that the risks have not been transferred by Cada Ltd to Funda bank. The risk of irrecoverable debts is still borne by Cada Ltd. The situation would have been different if Cada Ltd were not required to insure trade receivables and pay Funda bank an amount equal to trade receivables carrying value.

These two term show that trade receivables were simply used as collateral to get K255,000 (85% x K300,000). Thus, trade receivables should not be derecognised from the books of Cada Ltd. The difference between K300,000 and K255,000, K45,000 represents total interest charge for a period of three months. Cada Ltd has to recognise accrued finance cost of K45,000 in its statement of profit or loss for the year ended 31st May 2015 and a liability of K300,000 (K255,000 + K45,000) in its statement of financial position as at 31st May 2015.

Transaction Two

- 1) Basic earnings per share is calculated by profit after interest and tax from continuing activities divided by weighted average number of issued equity shares. Similarly, the said formula is used to calculate diluted earnings per share. However, the numerator and denominator are adjusted for the effects of future issue of shares. None the less, only those transactions that have dilutive potential of basic earnings per share are included in the calculation of diluted earnings per share.
- 2) The significance of calculating diluted earnings per share is to show the effects of future issue of equity shares on basic earnings per share.

3) Calculation of basic and diluted earnings per share

$$\begin{aligned}\text{Basic earnings per share} &= \frac{\text{Profit after interest and tax}}{\text{Weighted average number of shares}} \\ &= \frac{\text{K}32,000 (60,000 - 12,000 - 16,000)}{187,500 \text{ W1}} \\ &= \text{K0.17 per share}\end{aligned}$$

$$\begin{aligned}\text{Diluted earnings per share} &= \frac{\text{Profit after interest and tax}}{\text{Weighted average number of shares}} \\ &= \frac{\text{K}32,000 \text{ W2}}{188,500 \text{ W3}} = \text{K0.16 per share}\end{aligned}$$

Workings

W1 Weighted average number of shares under basic earnings per share

Shares issued at market price	50,000 x 9/12	37,500
Bonus shares issued	15,000 x 12/12	15,000
Shares at 1 st June 2014	{(100,000/0.5) – 50,000 – 15,000} x 12/12	<u>135,000</u>
Weighted average number of shares		<u>187,500</u>

W2 Profit after interest and tax under diluted earnings per share

	K
Profit after interest and tax under basic earnings per share	<u>132,000</u>
Interest savings on convertible loan 10% x K200,00 x (1 – 0.3)	<u>14,000</u>

W3 Weighted average number of shares under diluted earnings per share

Weighted average number of shares under basic earnings per share	187,500
Shares under share option $10 \times 1,000$	10,000
Shares under share option at fair value $10,000 \times K1.8/K2$	<u>(9,000)</u>
	<u>188,500</u>
Shares under convertible loan $(K200,000/K1,000) \times 200$ shares	<u>40,000</u>

Dilutive potential of convertible loan stock

$$= K14,000/40,000 \text{ shares}$$

$$= K0.35$$

This is more than basic EPS of K0.17. The loan should therefore not be included in diluted EPS as it does not have dilutive potential.

SOLUTION FIVE

a) THABA- IAS 16 P.P.E MEASUREMENT METHODS

Cost model-subsequent measurement

- i) Normally based on the initial cost of the asset
- ii) The subsequent capital expenditure will be part of the cost of the asset
- iii) For depreciable asset, depreciation expense will be reported in the statement of profit or loss
- iv) In the statement of financial position the carrying value will be cost less accumulated depreciation and accumulated impairments losses
- v) No revaluation will be needed

Revaluation model-subsequent measurement

- i) The carrying value will be the re-valued. Any old accumulated depreciation is eliminated.
- ii) For depreciable asset depreciation will be calculated based on the re-valued amount
- iii) Depreciation expense will be reported in the statement of profit and loss
- iv) The carrying amount will be re-valued amount less subsequent accumulated depreciation and subsequent impairment losses
- v) For re-valuation surplus it will normally be reported as revaluation reserve in equity, unless it is reversing the previous revaluation deficit/loss in the statement of profit and loss

- vi) For re-valuation deficit it will normally be reported as an expense, unless it reversing the previous surplus reported in the statement of financial position
- vii) The IAS 16 allows the transfer of excess depreciation on revaluation surplus to retained earnings
- viii) Revaluation is done for the entire class to avoid cherry picking and regularly so that the carrying value of the asset is not materially different from the market value

b) The five-step model framework

The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework:

- i) Identify the contract(s) with a customer
- ii) Identify the performance obligations in the contract
- iii) Determine the transaction price
- iv) Allocate the transaction price to the performance obligations in the contract
- v) Recognise revenue when (or as) the entity satisfies a performance obligation.

Application of this guidance will depend on the facts and circumstances present in a contract with a customer and will require the exercise of judgment.

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.

Step 3: Determine the transaction price

The transaction price is the amount to which an entity expects to be entitled in exchange for the transfer of goods and services. When making this determination, an entity will consider past customary business practices.

Where a contract contains elements of variable consideration, the entity will estimate the amount of variable consideration to which it will be entitled under the contract. Variable consideration can arise, for example, as a result of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. Variable consideration is also present if an entity's right to consideration is contingent on the occurrence of a future event.

The standard deals with the uncertainty relating to variable consideration by limiting the amount of variable consideration that can be recognised. Specifically, variable consideration is only included in the transaction price if, and to the extent that, it is highly probable that its inclusion will not result in a significant revenue reversal in the future when the uncertainty has been subsequently resolved.

However, a different, more restrictive approach is applied in respect of sales or usage-based royalty revenue arising from licences of intellectual property. Such revenue is recognised only when the underlying sales or usage occur.

Step 4: Allocate the transaction price to the performance obligations in the contracts

Where a contract has multiple performance obligations, an entity will allocate the transaction price to the performance obligations in the contract by reference to their relative standalone selling prices. If a standalone selling price is not directly observable, the entity will need to estimate it. IFRS 15 suggests various methods that might be used, including:

- Adjusted market assessment approach
- Expected cost plus a margin approach
- Residual approach (only permissible in limited circumstances).

Any overall discount compared to the aggregate of standalone selling prices is allocated between performance obligations on a relative standalone selling price basis. In certain

circumstances, it may be appropriate to allocate such a discount to some but not all of the performance obligations.

Where consideration is paid in advance or in arrears, the entity will need to consider whether the contract includes a significant financing arrangement and, if so, adjust for the time value of money. A practical expedient is available where the interval between transfer of the promised goods or services and payment by the customer is expected to be less than 12 months.

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Revenue is recognised as control is passed, either over time or at a point in time.

Control of an asset is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. This includes the ability to prevent others from directing the use of and obtaining the benefits from the asset. The benefits related to the asset are the potential cash flows that may be obtained directly or indirectly. These include, but are not limited to:

- using the asset to produce goods or provide services;
- using the asset to enhance the value of other assets;
- using the asset to settle liabilities or to reduce expenses;
- selling or exchanging the asset;
- pledging the asset to secure a loan; and
- holding the asset.

An entity recognises revenue over time if one of the following criteria is met:

- the customer simultaneously receives and consumes all of the benefits provided by the entity as the entity performs;
- the entity's performance creates or enhances an asset that the customer controls as the asset is created; or
- the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

If an entity does not satisfy its performance obligation over time, it satisfies it at a point in time. Revenue will therefore be recognised when control is passed at a certain point in time.

Factors that may indicate the point in time at which control passes include, but are not limited to:

- the entity has a present right to payment for the asset;
- the customer has legal title to the asset;
- the entity has transferred physical possession of the asset;
- the customer has the significant risks and rewards related to the ownership of the asset; and
- the customer has accepted the asset.

Contract costs

The incremental costs of obtaining a contract must be recognised as an asset if the entity expects to recover those costs. However, those incremental costs are limited to the costs that the entity would not have incurred if the contract had not been successfully obtained (e.g. 'success fees' paid to agents). A practical expedient is available, allowing the incremental costs of obtaining a contract to be expensed if the associated amortisation period would be 12 months or less.

Costs incurred to fulfil a contract are recognised as an asset if and only if all of the following criteria are met:

- the costs relate directly to a contract (or a specific anticipated contract);
- the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- the costs are expected to be recovered.

These include costs such as direct labour, direct materials, and the allocation of overheads that relate directly to the contract.

The asset recognised in respect of the costs to obtain or fulfil a contract is amortised on a systematic basis that is consistent with the pattern of transfer of the goods or services to which the asset relates.

END OF SOLUTIONS