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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 21 August 2025. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Highlight **FOUR** non-financial objectives of an organisation. (4 marks)

(b) The following information was extracted from the statements of financial position of 10 companies in hotel and catering industries:

Companies in hotel and catering industry	Inventory Sh."000"	Current assets Sh."000"	Current liabilities Sh."000"
A	2,700	5,000	10,000
B	6,500	12,500	25,000
C	18,600	25,000	50,000
D	21,600	37,500	75,000
E	12,000	25,000	100,000
F	3,000	5,000	1,250
G	6,700	12,500	6,250
H	18,700	25,000	12,500
I	16,600	37,500	18,750
J	35,000	50,000	25,000

The 10 companies (A - J) intend to benchmark themselves against their liquidity position and then determine the average liquidity for the industry.

Required:
Calculate the industry average ratio for the following:

(i) Current ratio. (3 marks)

(ii) Acid-test-ratio. (3 marks)

(c) Ahadi Ltd. is a leading manufacturer of pharmaceutical products in Kenya. Ahadi Ltd. has a customer based in South Africa known as Tesco Ltd. Ahadi Ltd. made a credit sale to Tesco Ltd. on 1 October 2024 for SA Rd 100,000. Ahadi Ltd. received part payment on 30 November 2024 of SA Rd 60,000. The exchange rates applicable during the financial year were as follows:

1 October 2024 Ksh.1 = SA Rd 1.25
30 November 2024 Ksh.1 = SA Rd 1.20
31 December 2024 Ksh.1 = SA Rd 1.1

Required:
Show how the above transactions should be recorded in the books of Ahadi Ltd. for the year ended 31 December 2024. (4 marks)

(d) Hugoh Ltd. is a newly established company in the book-selling industry, where Dunhill Ltd. is a market leader. The management of Hugoh Ltd. aims to compare its financial performance with that of Dunhill Ltd. However, due to significant differences in their size and operations scale, a direct comparison of their financial statements is a challenge.

The following are the summarised financial statements of both companies.

Statement of profit or loss for the year ended 30 June 2025:

	Hugoh Ltd. Sh."million"	Dunhill Ltd. Sh."million"
Sales	340	1,700
Cost of sales	(238)	(1,156)
Gross profit	102	544
Operating expenses	(78)	(391)
Interest expenses	(5)	(5)
Income tax	(6)	(47)
Net profit	13	101

Statement of financial position as at 30 June 2025:

	Hugoh Ltd. Sh."million"	Dunhill Ltd. Sh."million"
Assets:		
Non-current assets	57	263
Current assets	34	175
	91	438
Equity and liabilities:		
Equity:		
Shares capital	26	257
Retained earnings	13	110
Non-current liabilities:		
Long term liabilities	46	44
Current liabilities	6	27
	91	438

Required:

Vertical analysis of statement of profit or loss for both Hugoh Ltd. and Dunhill Ltd. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) Outline **THREE** techniques used in financial statements analysis. (3 marks)

(b) Kalikor Ltd. has for many years neglected the impacts of its activities on the environment. In order to counter the effect of global warming, the company now wishes to partner with the government in projects that generate carbon credits.

Required:

Identify **THREE** activities that the company could engage in order to earn carbon credits. (3 marks)

(c) The income before tax for Abode Ltd. for the year 2023 was Sh.101,000 and Sh.77,400 for the year 2024. However, the accountant noted that the following errors had been made:

1. Sales for year 2023 included amounts of Sh.38,200 which had been received in cash during the year 2023, but for which the related products were delivered in year 2024. Title to the products did not pass to the purchaser until 2024.
2. The inventory on 31 December 2023 was understated by Sh.8,640
3. The book keeper in recording interest expense for both year 2023 and year 2024 on bonds payable made the following entry on annual basis:
   - Effective interest year 2023 Sh.16,450 and year 2024 Sh.16,552.
   - Interest expense Sh.15,000 and cash Sh.15,000.
4. The bonds have a face value of Sh.250,000 and pay a stated interest rate of 6%. They were issued at a discount of Sh.15,000 on 1 January 2023 to yield an effective interest rate of 7%. (Assume that the effective yield method should be used).
5. Ordinary repairs to equipment had been erroneously charged to the equipment account during year 2023 and year 2024. Repairs amounting to Sh.8,500 in year 2023 and Sh.9,400 in year 2024 were so charged. The company applies a rate of 10% to the balance in the equipment account at the end of the year in its determination of depreciation charges.

Required:
Prepare a schedule showing the determination of corrected income before taxes for the year 2023 and year 2024. (6 marks)

(d) The following set of balances have been extracted from the accounting records of Sunny Limited as at 30 June 2025 for the purpose of preparing the projected financial statements for the year ending 30 June 2026:

	Sh.“000”
Net sales	405,000
Cost of goods sold	307,800
Inventory at 30 June 2025	42,500
Trade receivables	24,200
Bank balance	19,500
Trade payables	23,600
Staff salaries	22,500
Depreciation expense	30,800
Selling expenses	10,800
Gain on disposal of equipment	1,600
Interest expense	3,000
Investment income	3,300
Income tax expense	10,500
Plant, property and equipment	114,900
Equity investments	66,000
Long term borrowings	25,000
Ordinary shares capital	100,000
Retained earnings at 1 July 2024	94,000

The following assumptions relate to the year ending 30 June 2026:

1. Sales revenue will increase by Sh.15 million.
2. Gross profit margin will improve by 1% percentage point.
3. Staff salaries will rise by 4%.
4. Selling expenses will reduce by Sh.1,700,000.
5. There will be neither sale nor purchase of non-current assets.
6. New long-term loan of Sh.30 million had been obtained on 1 July 2025. Interest on the borrowings is charged at the rate of 12% per annum.
7. A gain in fair value of the equity investments amounting to Sh.4 million is anticipated.
8. Corporation tax rate of 30% is assumed.
9. Selected projected items of the year ending 30 June 2026 are set below.

	Sh.“000”
Property, plant and equipment	92,000
Inventory	43,600
Trade receivables	25,900
Trade payables	24,800

Required:
Prepare a single-step projected statement of profit or loss for the year ending 30 June 2026. (8 marks)
(Total: 20 marks)

QUESTION THREE

(a) Explain **SIX** steps that a securities and investment analyst is expected to follow when undertaking financial statement analysis. (6 marks)

(b) The following financial statements were extracted from the books of Mango’s Ltd. as at 31 March:

	2025 Sh.“000”	2024 Sh.“000”
Non-current assets:		
Freehold land and building	50,400	36,000
Plant and machinery	17,580	19,050
Investment at cost	10,800	11,250
Goodwill	8,400	8,700
	87,180	75,000

Current assets:	Sh."000"	Sh."000"
Inventory	30,150	26,100
Trade receivable	18,420	23,400
Short term investments	5,130	2,520
Cash in hand	600	1,290
	141,480	128,310
Equity and liabilities:		
Equity:		
Ordinary share capital	76,500	72,000
Share premium	4,500	2,250
Revaluation reserve	13,500	-
Revenue reserve	18,450	15,750
	112,950	90,000
Current liabilities:		
Trade payables	17,550	15,750
Bank overdraft	7,170	19,620
Proposed dividend	1,350	1,140
Corporate tax	2,460	1,800
	141,480	128,310

Additional information:

1. During the year, impairment of goodwill was estimated to be Sh.1,260,000.
2. The revaluation reserves relate to freehold land and building.
3. The statement of profit or loss extract for the year ended 31 March 2025 was as follows:

	Sh."000"	Sh."000"
Profit before tax		7,200
Less: Corporation tax		(2,700)
Profit after tax		4,500
Dividends interim	450	
Dividends proposed	1,350	(1,800)
Retained earnings		2,700

4. During the year, a plant with a net book value of Sh.2,200,000 was sold for Sh.4,410,000. The plant had an original cost of Sh.9,000,000.
5. Part of investment was sold during the year at a profit of Sh.480,000.
6. Depreciation on plant and machinery amounting to Sh.3,450,000 was charged to the statement of profit or loss during the year.

Required:

Cashflow statement in accordance with International Accounting Standards (IAS) 7 "statement of cashflow". (14 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Explain **TWO** application areas in financial statements analysis in which Monte Carlo simulation could be used. (4 marks)

(b) Highlight **FOUR** consequences of accounting scandals in public limited entities. (4 marks)

(c) On 1 May 2022, Party Limited issued a 10.5% Sh.36 million convertible loan notes at par value. There were no issue costs. Interest is payable in arrears on 30 April each year. The loan note would be redeemable at par on 1 May 2026 or convertible into ordinary shares at the holders option on the basis of forty (40) ordinary shares for each Sh.100 of the loan note. A similar loan note issued by Safari Ltd. without the conversion option attract interest at the rate of 13.5% per annum.

Required:

(i) With suitable computations, analyse the accounting treatment of the above financial instruments in the financial statements of Party Limited for the year ended 30 April: 2022, 2023, 2024 and 2025. (10 marks)

(ii) Explain the accounting treatment of convertible financial instruments as per the International Accounting Standards (IAS) 32 – Financial Instruments. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) (i) Explain the term "Shenanigan Strategies" as used in financial statements analysis. (4 marks)

(ii) Describe **TWO** basic strategies underlying accounting Shenanigans. (4 marks)

(b) Michelyn Limited is a public limited company operating in the transport industry. It intends to achieve economies of scale by entering into a business combination with a similar partner. To achieve this, Michelyn Limited acquired all of the ordinary shares capital of Finestore Limited by way of shares exchange on 1 April 2024. Michelyn Limited issued 5 of its own shares to Finestore Limited for every 4 shares in Finestore Limited. The market value of Michelyn Limited shares on 1 April 2024 was Sh.60 each. The shares issue has not been recorded in Michelyn Limited's books.

The summarised financial statements of both companies for the year ended 30 September 2024 were as follows:

Statement of profit or loss for the year ended 30 September 2024:

	Michelyn Limited Sh."000"	**Finestore Limited Sh."000"**
Sales revenue	144,000	120,000
Cost of sales	(99,600)	(70,800)
Gross profit	44,400	49,200
Operating expenses	(9,600)	(6,000)
Profit before tax	34,800	43,200
Corporate tax	(12,000)	(18,000)
Profit for the year	22,800	25,200

Statement of financial position as at 30 September 2024:

	Michelyn Limited		**Finestore Limited**	
	Sh."000"	**Sh."000"**	**Sh."000"**	**Sh."000"**
Non-current assets:				
Property, land and equipment		384,000		210,000
Investments		-		76,800
		384,000		286,800
Current assets:				
Inventory	136,800		141,600	
Trade receivable	98,400		145,200	
Bank	3,000	238,200	1,200	288,000
		622,200		574,800
Equity and liabilities:				
Ordinary share capital (Sh.100 each)		120,000		72,000
Share premium		24,000		14,400
Retained earnings		343,200		256,200
		487,200		342,600
Non-current liabilities:				
10% loan		30,000		108,000
Current liabilities:				
Trade payables	91,800		106,200	
Corporate tax	13,200	105,000	18,000	124,200
		622,200		574,800

Additional information:

1. The fair value of Finestore Limited investment was Sh.30 million in excess of its book value at the date of acquisition.
2. No dividends have been paid by either of the companies.
3. Goodwill was reviewed on 30 September 2024. Sh.18 million loss is to be recognised.
4. The fair value of Finestore Limited other net assets were equal to the book value.

Required:

(i) Consolidated statement of profit or loss for the year ended 30 September 2024. (6 marks)

(ii) Consolidated statement of financial position as at 30 September 2024. (6 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

FRIDAY: 25 April 2025. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Describe **FOUR** benefits of using cash flow statements by financial analysts. (4 marks)

(b) In the context of financial reporting, analyse the accounting treatment of a discontinued operation in the financial statements of an entity. (6 marks)

(c) Cool Energy, a petroleum company, reported a net income of Sh.1,803.8 million on revenues of Sh.54,618.6 million for the year ended 31 December 2024. Interest expense totalled to Sh.359.97 million and preferred dividends totalled to Sh.12.5 million. Average total assets for the year ended 31 December 2024 were Sh.17,527.9 million. The income tax rate is 30%. Average preferred shareholders equity totalled to Sh.204.3 million and average common shareholders' equity totalled to Sh.6,562.3 million.

Required:

(i) Compute the rate of return on asset (ROA). (1 mark)

(ii) Compute the rate of return on capital employed (ROCE). (1 mark)

(iii) Calculate the amount of net income to common shareholders derived from the excess return on creditors' capital, the excess return on preferred shareholders' capital and the return on common shareholder's capital. (4 marks)

(d) Drum Ltd. sponsors a defined benefit pension plan. The corporation's actuary provides the following information about the plan:

	1 January 2024 Sh."000"	**31 December 2024 Sh."000"**
Defined benefit obligation	2,500	3,300
Plan assets (fair value)	1,700	2,620
Discount rate	-	10%
Pension asset/liability	800	?
Service costs for the year 2024		400
Contributions (funding in 2024)		700
Benefits paid in 2024		200

Required:

Calculate the amount of other comprehensive income as at 31 December 2024. Assume the 1 January 2024 balance was zero. (4 marks)

(Total: 20 marks)

QUESTION TWO

House Limited, a public limited entity, acquired a 75% controlling interest in Swift Limited, another public limited entity on 1 July 2024. House Limited made an immediate cash payment to the owners of Swift Limited amounting to Sh.22,600,000 as consideration for the acquisition. On 1 January 2025, House Limited also purchased 30% of the ordinary shares of Almond Limited, a public limited entity for a cash consideration of Sh.3,800,000.

The following are the statements of profit or loss and other comprehensive income of the group of companies for the year ended 31 March 2025:

	House Limited Sh."000"	Swift Limited Sh."000"	Almond Limited Sh."000"
Revenue	140,500	108,000	64,600
Cost of sales	(96,600)	(78,000)	(40,900)
Gross profit	43,900	30,000	23,700
Distribution costs	(9,500)	(6,400)	(5,600)
Administrative expenses	(10,800)	(7,400)	(6,300)
Operating profit	23,600	16,200	11,800
Finance costs	(1,100)	(600)	(400)
Profit before tax	22,500	15,600	11,400
Income tax expense	(6,800)	(5,200)	(3,400)
Profit for the year	15,700	10,400	8,000
Other comprehensive income:			
Gain on property revaluation	3,600	2,400	-
Total comprehensive income	19,300	12,800	8,000
Equity balances at 1April 2024:			
Ordinary shares capital (Sh.10 par value)	20,000	10,000	2,000
Retained earnings	29,400	13,900	4,000

Additional information:

1. The fair values of net assets of Swift Limited at the date of acquisition were equal to their carrying amount. The property of Swift Limited was revalued during the post-acquisition period.
2. During the post-acquisition period, Swift Limited sold goods to House Limited for Sh.7,200,000. Swift Limited makes a gross profit margin of 25% on all its sales. One third (⅓) of these goods were still held by House Limited in its inventory at 31 March 2025.
3. House Limited measures goodwill and non-controlling interest using the fair value method. At the date of acquisition, the non-controlling interest in Swift Limited had a fair value of Sh.7,000,000.
4. Impairment review performed on 31 March 2025 revealed that neither the goodwill on acquisition of Swift Limited nor the investment in Almond Limited had been impaired.
5. Assume that profits and losses accrued evenly throughout the year.

Required:

(a) Calculate the value of goodwill arising on acquisition of Swift Limited as at 1 July 2024. (4 marks)

(b) Determine the equity-accounted value of investment in Almond Limited as at 31 March 2025. (2 marks)

(c) Prepare the consolidated statement of profit or loss and other comprehensive income for House Group for the year ended 31 March 2025. (14 marks)

(Total: 20 marks)

QUESTION THREE

(a) Identify **THREE** user groups of financial statements citing the information they are likely to require. (3 marks)

(b) Explain **FIVE** purposes of the International Accounting Standards Board's (IASB's) conceptual framework for financial reporting. (5 marks)

(c) Discuss **THREE** uses of income tax disclosures on a company's financial statement to a financial analyst. (6 marks)

(d) Joy Ltd. reported a pre-tax financial income of Sh.800,000 for the year ended 31 December 2024. The following items caused taxable income to be different from pre-tax financial income during the year:

1. Depreciation on the tax return is greater than depreciation on the income statement by Sh.160,000.
2. Rent collected on the tax return is greater than rent revenue reports on the income statement by Sh.270,000.
3. Fines for pollution appear as an expense of Sh.110,000 on the income statement.

Joy Ltd.'s tax rate is 30% for all years. The company expects to report taxable income in all future years. There are no deferred taxes as at 1 January 2024.

Required:
Calculate:

(i) Current income tax payable for the year 2024. (2 marks)

(ii) Net deferred tax for the year 2024. (3 marks)

(iii) Effective income tax rate for the year 2024. (1 mark)

(Total: 20 marks)

QUESTION FOUR

(a) Distinguish between "conservative accounting" and "aggressive accounting". (4 marks)

(b) Evaluate **THREE** conditions that may be conducive for producing and issuing low quality financial reports. (6 marks)

(c) Axe Ltd. purchased equipment on 2 January 2021 for Sh.112,000,000. The equipment had an estimated useful life of 5 years with an estimated salvage value of Sh.12,000,000. The company uses straight line depreciation method on all assets. On 2 January 2025, the company exchanged this equipment plus Sh.12,000,000 in cash for newer equipment. The old equipment had a fair value of Sh.50,000,000.

Required:

(i) Determine the entries that the company should make in its books of account on the close of this transaction. (Assume the exchange has commercial substance). (3 marks)

(ii) Discuss how the exchange affects comparisons of the return on asset ratio for Axe Ltd. in the year of the exchange compared to prior years. (2 marks)

(d) The shareholder's equity sector of the statement of financial position for Zoe Ltd. included the following accounts as at 31 December 2023:

	(Sh."million")
Paid in capital:	
120 million ordinary shares (Sh.1 par value)	120
Paid in capital-excess of par	836
Retained earnings	2,449
Total shareholders' equity	3,405

During the year ended 31 December 2024, the following events and transactions took place:

1. On 11 March 2024, Zoe Ltd. issued 10 million of its 9.2% preferred shares, Sh.1 par value shares, for Sh.44 per share.
2. On 22 November 2024, 1 million ordinary shares, Sh.1 par value, were issued in exchange for eight machines. Each machine was built to custom specifications so no cash price was available. Zoe Ltd.'s shares were listed at Sh.10 per share.
3. On 23 November 2024, 1 million of the ordinary shares and 1 million preferred shares were sold for Sh.60 million. The preferred shares had not traded since March 2024 and their market value was uncertain.

The net income for the year ended 31 December 2024 was Sh.400 million and the company paid the 9.2% dividend on the 11 million preferred shares.

Required:
Prepare the shareholders' equity section of the comparative statement of financial position for Zoe Ltd. as at 31 December 2023 and 31 December 2024. (5 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following extracts of financial statements were obtained from the financial records of Global Limited with a view of analysing the company's working capital cycle and the dividend policy:

Extracts of statement of profit or loss for the years ended 31 December:

	2024	**2023**
	Sh.“000”	**Sh.“000”**
Revenue	584,000	511,000
Cost of sales	(438,000)	(401,500)
Gross profit	146,000	109,500
Operating expenses	(74,600)	(73,900)
Finance costs	(8,600)	(8,400)
Profit before tax	62,800	27,200
Income tax expense	(17,800)	(9,600)
Profit for the year	45,000	17,600

Extracts of statement of financial position as at 31 December:

	2024	**2023**
Current assets:	**Sh.“000”**	**Sh.“000”**
Inventory	50,400	44,000
Trade receivables	62,400	53,200
Current liabilities:		
Trade payables	44,400	38,500
Equity:		
Ordinary share capital (Sh.10 par value)	15,000	10,000
Share premium	1,500	1,000
Retained profit brought forward	51,800	36,400
Retained profit for the year	36,900	15,400

Assume a 365-day financial year of the company.

The market prices of the company's ordinary shares were Sh.24 and Sh.22 as at 31 December 2024 and 31 December 2023 respectively.

Required:
Calculate the following financial ratios for Global Limited for each of the years ended 31 December 2023 and 31 December 2024:

(i) Inventory holding period. (2 marks)
(ii) Receivables collection period. (2 marks)
(iii) Payables payment period (use cost of sales). (2 marks)
(iv) Cash conversion cycle. (2 marks)
(v) Dividend pay-out ratio. (2 marks)
(vi) Dividend yield. (2 marks)

(b) On 1 December 2020, Perry Limited entered into a contract to lease an item of machinery from a supplier for four years. The terms of the lease were that Perry Limited was required to pay annual rent of Sh.1,550,000 in arrears commencing on 30 November 2021. Initial direct costs incurred on the lease amounted to Sh.429,570 and were paid for by Perry Limited.

The machinery had a remaining economic useful life of six years at the commencement of the lease. The lease contract did not contain any purchase option for the lessee.

The interest rate implicit in the lease was at 13% per annum.

Note: Present value interest factor of an annuity (PVIFA) at 13% for 4 years is 2.97447.

Required:
Analyse the accounting treatment of the above lease transactions in the financial statements of Perry Limited for the years ended 30 November 2021, 2022, 2023 and 2024. (8 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 5 December 2024. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Analyse the impact of climate changes on the following elements of financial statements:

(i) Bearer biological assets. (2 marks)

(ii) Intangible assets. (2 marks)

(iii) Inventories. (2 marks)

(b) Discuss **FOUR** red flags that would indicate financial statements are of poor quality. (8 marks)

(c) The following accounting information was obtained from the financial records of Aviator Limited for the year ended 31 December 2023:

	Sh."000"
Revenue	504,000
Operating profit	130,200
Finance costs	40,500
Income tax expense	26,700
Total assets	672,000
Shareholders' equity	420,000
Long-term borrowings	300,000

Required:

Compute the company's return on shareholders' funds (ROSF) using the three-step Du Point analysis. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) Describe **TWO** ways on how investment properties are measured. (4 marks)

(b) Explain **TWO** determinants of earnings quality. (4 marks)

(c) Square Limited, a public limited entity has provided the following details for the financial year ended 30 September 2024:

The following information has been extracted from the financial records of the company with a view of determining the deferred tax:

1. Property, plant and equipment has a carrying value of Sh.92,500,000 and a tax base of Sh.83,500,000. During the year ended 30 September 2024, the property was revalued upwards at a gain of Sh.3,500,000.
2. Inventory is valued at the lower of cost or net realisable value. The cost amounted to Sh.37,500,000 while the net realisable value was estimated at Sh.33,900,000.
3. Trade receivables are carried at Sh.13,500,000 after making allowance for doubtful debts of Sh.1,500,000. The allowance for doubtful debt is not allowed for tax purposes.

4. During the year to 30 September 2024, development expenditure amounting to Sh.14,400,000 was capitalised. Amortisation of Sh.800,000 was charged to profit or loss for the year. The development expenditure was allowed for tax purposes in full during the year.
5. Trade and other payables have been carried at Sh.18,000,000. Included in the other payables are accrued expenses of Sh.3,000,000 whose related expenses are allowable for tax purposes on cash paid basis.
6. Deferred tax liability as at 1 October 2023 amounted to Sh.2,160,000.
7. The basic income tax rate applicable to Square Limited is 30%.

Required:

(i) Compute the relevant temporary differences. (8 marks)

(ii) Determine the deferred tax charge or credit for the year ended 30 September 2024. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) Differentiate between "top down approach" and "bottom up approach" techniques of analysing financial statements. (4 marks)

(b) Popote Ltd. owns two subsidiaries acquired as follows:

1 July 2016	80% of Tatu Ltd. for Sh.5 million when the book value of the net assets of Tatu Ltd. was Sh.4 million.
30 November 2022	65% of Nzoia Ltd. for Sh.2.6 million when the book value of the net assets of Nzoia Ltd. was Sh.3.35 million.

The companies' statement of profit or loss and other comprehensive income for the year ended 31 March 2023 were as follows:

	Popote Ltd. Sh."000"	Tatu Ltd. Sh."000"	Nzoia Ltd. Sh."000"
Revenue	5,000	3,000	2,910
Cost of sales	(3,000)	(2,300)	(2,820)
Gross profit	2,000	700	90
Administrative expenses	(1,000)	(500)	(150)
Other income	230	-	-
Finance costs	-	(50)	(210)
Profit/(loss) before tax	1,230	150	(270)
Income tax expense	(300)	(50)	-
Profit/(loss) for the year	930	100	(270)
Other comprehensive income that will not be reclassified to profit or loss, net of tax	130	40	120
Total comprehensive income for the year	1,060	140	(150)
Dividends paid during the year	200	50	-

Additional information:

1. On 1 April 2022, Nzoia Ltd. issued Sh.2.1 million 10% loan stock to Popote Ltd. Interest is payable twice yearly on 1 October and 1 April. Popote Ltd. has accounted for the interest received on 1 October 2022 only.
2. On 1 July 2022, Tatu Ltd. sold a freehold property to Popote Ltd. for Sh.800,000 (land element – Sh.300,000). The property original cost was Sh.900,000 (land element – Sh.100,000) on 1 July 2012. The property's total useful life was 50 years on 1 July 2012 and there has been no change in the useful life since then. Tatu Ltd. has credited the profit on disposal to administrative expenses.
3. The property, plant and equipment of Nzoia Ltd. on 30 November 2022 was valued at Sh.500,000 (book value Sh.350,000) and was acquired in April 2022. The property, plant and equipment has a total useful life of ten years. Nzoia Ltd. has not adjusted its accounting records to reflect fair values. The group accounting policy is to measure non-controlling interests at the proportionate share of the fair value of net identifiable assets at acquisition.
4. All companies use the straight line method of depreciation and charge a full year's depreciation in the year of acquisition and none in the year of disposal. Depreciation on fair value adjustments in time apportioned from the date of acquisition.
5. Popote Ltd. charges Tatu Ltd. an annual fee of Sh.85,000 for management services and this has been included in other income.

6. Popote Ltd. has accounted for its dividend received from Tatu Ltd. in other income.
7. Impairment tests conducted during the year revealed recoverable amounts of Sh.7,040,000 for Tatu Ltd. and Sh.3,700,000 for Nzoia Ltd. versus book value of net assets of Sh.4,450,000 and Sh.3,300,000 in the separate financial statements of Tatu Ltd. and Nzoia Ltd. respectively (adjusted for the effects of group fair value adjustments). No impairment losses had previously been recognised.

Required:
Prepare the consolidated statements of profit or loss and other comprehensive income for Popote Group for the year ended 31 March 2023. (16 marks)
(Total: 20 marks)

QUESTION FOUR
(a) The following data is available for a technology company:

Year	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
	Sh."000"	**Sh."000"**	**Sh."000"**	**Sh."000"**	**Sh."000"**	**Sh."000"**
Sales	3.248	2.672	2.045	1.761	1.820	1.723
Cost of goods sold	1.919	1.491	0.898	1.201	1.316	1.228
Receivables	0.281	0.139	0.099	0.076	0.115	0.045
Inventories	0.194	0.176	0.010	0.002	0.000	0.000
Accounts payable	0.223	0.317	0.366	1.423	0.704	0.674

Notes:
- Assume there are 365 days in a year.
- Use the cost of goods sold as an approximation of purchases for sales.

The following information has been provided:

Cash conversion cycle = DIO + DSO – DPO
Where:

DIO → Days inventory outstanding = $\frac{\text{Number of days in period}}{\text{Inventory turnover ratio}}$

DSO → Days sales outstanding = $\frac{\text{Number of days in period}}{\text{Receivable turnover ratio}}$

DPO → Days payable outstanding = $\frac{\text{Number of days in period}}{\text{Payable turnover ratio}}$

Receivable turnover ratio = $\frac{\text{Total revenue}}{\text{Average receivable}}$

Payable turnover ratio = $\frac{\text{Purchases}}{\text{Average trade payable}}$

Required:
(i) Calculate the cash conversion cycle for year 2019 to 2023. (6 marks)

(ii) Explain the firm's performance based on your result in (a) (i) above. (2 marks)

(b) Pamoja Ltd. is a multinational company. The company prepares a segmental report for inclusion in its financial accounts for year ended 30 September 2024. The company has divided its operations into the processing, refining and finishing and operates in Nairobi, Mombasa and Kisumu. The following details relates to Pamoja Ltd.:

	Sh."000"
Sales to customer outside the company by the processing division	44,096.25
Sales to customers outside the company by Nairobi	105,750.00
Sales not derived from processing, refining and finishing	12,337.50
Sales made to customers outside the company by finishing division	74,808.75
Assets used by the Kisumu companies	114,750.00
Assets not allocated to processing refining and finishing	55,710.00
Assets used by processing companies	119,062.50
Sales by finishing to other companies	13,717.50
Assets used by refining	66,656.25

	Sh."000"
Assets used by Nairobi	156,825.00
Sales not allocated to Nairobi, Mombasa or Kisumu	12,337.50
Sales by processing to other companies	4,601.25
Sales made by the company in Mombasa	5,553.75
Expenses not allocated to Nairobi, Mombasa or Kisumu	15,273.75
Sales to customers outside the company by Kisumu	27,101.25
Expenses not allocated to processing refining or finishing	18,765.00
Sales by Mombasa to other companies	7,938.75
Sales to customers outside the company by refining	19,500.00
Sales by Nairobi to other companies	9,112.50
Assets used by finishing	167,325.00
Assets used by Mombasa	81,225.00
Assets not allocated to Nairobi, Mombasa or Kisumu	55,953.75
Segmented net profit made by industry: Processing	9,157.50
Refining	22,185.00
Finishing	3,078.75
Segmental net profit made by geographical area: Nairobi	18,273.75
Mombasa	11,726.25
Kisumu	1,826.25
Consolidated net profit by industry	33,667.50
Consolidated net profit by geographical area	30,176.25

Required:

Prepare geographical segmental report for the year ended 30 September 2024. (12 marks)

(Total: 20 marks)

QUESTION FIVE

(a) As an analyst, discuss **TWO** challenges you could face while analysing financial statements. (2 marks)

(b) Joshua Mwamba analysis focuses on company XYZ, a local commercial bank. He considers the firm's capital adequacy as measured by the key capital ratios. Common equity Tier 1 capital, total Tier 1 capital and total capital shown below:

At 31 December:	**2023**	**2022**	**2021**
Regulatory capital	**(Sh."000")**	**(Sh."000")**	**(Sh."000")**
Common equity Tier 1 capital	146,424	142,367	137,100
Additional Tier 1 capital	22,639	20,443	17,600
Tier 2 Capital	22,456	27,564	38,200
Total regulatory capital	191,519	190,374	192,900

At 31 December	**2023**	**2022**	**2021**
Regulatory capital	**(Sh."000")**	**(Sh."000")**	**(Sh."000")**
Risk-weighted assets (RWAs) by risk type:			
Credit risk	960,763	989,639	968,600
Market risk	44,100	36,910	49,600
Operational risk	293,825	256,300	224,300
Total RWAs	1,298,688	1,282,849	1,242,500

Required:

(i) Analyse company XYZ's capital adequacy over the last three years. (6 marks)

(ii) Explain to the management of XYZ company your finding from the analysis of capital adequacy in (b) (i) above. (2 marks)

(c) The directors of Welfare Limited are in the process of finalising the financial statements for the year ended 30 November 2024 for the purpose of financial statement analysis. They have tasked the financial analyst of the company to advise on the liquidity and solvency positions of the company.

Extracts from the financial statements of Welfare Limited for the year ended 30 November 2024 together with the comparative figures are as shown below:

Extracts of statements of financial position as at 30 November:

	2024	2023
Current assets:	**Sh."000"**	**Sh."000"**
Inventories	13,260	8,625
Accounts receivable	21,900	19,120
Cash and cash equivalents	12,780	10,880
	47,940	38,625
Equity and liabilities:		
Ordinary share capital	15,000	12,000
Share premium	3,000	2,000
Retained profit	3,375	3,000
Total equity	21,375	17,000
Non-current liabilities:		
12.5% bonds	32,000	24,000
Deferred tax	1,880	1,470
Lease liabilities	4,920	7,350
	38,800	32,820
Current liabilities:		
Accounts payable	21,320	14,700
Lease liabilities	1,080	1,650
Current tax	3,100	2,400
	25,500	18,750

Extracts of statements of profit or loss for the years ended 30 November:

	2024	2023
	Sh."000"	**Sh."000"**
Gross profit	43,400	40,470
Operating expenses	(31,160)	(27,240)
Finance costs	(4,800)	(4,200)
Profit before tax	7,440	9,030

Required:
Calculate the following financial ratios for Welfare Limited for the two years ended 30 November 2023 and 2024:

(i) Current ratio. (2 marks)

(ii) Quick (acid-test) ratio. (2 marks)

(iii) Gearing ratio (debt/debt + equity). (2 marks)

(iv) Interest cover. (2 marks)

(v) Debt to capital ratio. (2 marks)
(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 22 August 2024. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Explain **TWO** fundamental qualitative characteristics of useful financial information. (4 marks)

(b) In the context of accounting for foreign currency transactions, describe **TWO** primary factors to consider when determining the functional currency. (4 marks)

(c) Highlight **FOUR** disclosure requirements of segmental financial information. (4 marks)

(d) On 1 September 2020, Ground Limited purchased Sh.120,000,000, 8% four-year bond at a discount rate of 10%. The bond will be redeemed on 1 September 2024 at a premium of Sh.7,992,000 above the nominal value.

The effective rate of interest is 12% per annum.

The transaction costs incurred amounted to Sh.2,500,000.

Ground Limited intends to collect the contractual cash flows which comprise solely of interest and capital repayment and therefore the financial asset was designated at amortised cost.

Required:
Using suitable calculations, analyse the accounting treatment of the above financial asset in the financial statements of Ground Limited for the years ended 31 August: 2021, 2022, 2023 and 2024.
(Round off your answer to the nearest one thousand). (8 marks)
(Total: 20 marks)

QUESTION TWO

(a) Explain **FOUR** reasons why managers may be deterred from engaging in earnings management. (4 marks)

(b) Differentiate between "cash flow hedge" and "fair value hedge". (4 marks)

(c) A financial analyst has come across the Beneish's earnings manipulation model and is interested in determining whether Tetu Ltd. is engaged in earnings manipulation. The financial analyst considers two variables namely; Days Sales Receivable Index (DSRI) and Depreciation Index (DEPI) whose readings are 1.19 for each.

Required:
Explain the implications of the DSRI and DEPI variables for Tetu Ltd. (3 marks)

(d) Melinda Wambui is evaluating three general insurers and has collected the following information for the latest financial year:

Description	**AML Ltd.**	**Elite Ltd.**	**Swara Ltd.**
	Sh. "000"	**Sh. "000"**	**Sh. "000"**
Loss expense and loss adjustment expense	5,400	3,212	2,467
Underwriting expense	2,111	1,860	1,387
Dividends to policyholders (shareholders)	412	232	148
Net premiums earned	8,114	5,445	4,087
Net premium written	8,217	5,348	4,299

The following ratios have been provided:

- Loss and loss adjustment expense ratio = $\frac{\text{Loss expense + Loss adjustment expense}}{\text{Net premium earned}} \times 100$

- Underwriting expense ratio = $\frac{\text{Underwriting expense}}{\text{Net premium written}} \times 100$

- Combined ratio before dividends = Loss and loss adjustment expense ratio + Underwriting expense ratio

- Dividend to policyholders (shareholders) = $\frac{\text{Dividends to shareholders}}{\text{Net premium earned}} \times 100$

- Combined ratio after dividends = Combined ratio before dividends - Dividends to policy holders ratio

Required:
Determine the following:

(i) Loss and loss adjustment ratio for each insurer. (1 mark)

(ii) Underwriting expense ratio for each insurer. (1 mark)

(iii) Combined ratio before dividends for each insurer. (1 mark)

(iv) Dividend to policy holder ratio for each insurer. (1 mark)

(v) Combined ratio after dividends for each insurer. (1 mark)

(vi) The most profitable insurer on a combined ratio basis. (1 mark)

(vii) The most efficient insurer in operations. (1 mark)

(viii) The most profitable insurer on an overall basis. (2 marks)

(Total: 20 marks)

QUESTION THREE

The following draft financial statements have been extracted from the financial records of Skyview Limited for the purpose of vertical analysis of the elements of financial statements:

Statements of financial position as at 31 May:

	2024	**2023**
	Sh.“000”	**Sh. “000”**
Assets:		
Non-current assets:		
Property, plant and equipment	19,200	18,500
Intangible assets	12,600	9,500
	31,800	28,000
Current assets:		
Inventory	10,800	11,500
Trade receivables	10,200	7,000
Bank balance	7,200	3,500
Total assets	60,000	50,000
Equity and liabilities:		
Equity:		
Ordinary share capital	18,000	13,500
Share premium	6,000	4,500
Retained profit	13,200	12,000
Total equity	37,200	30,000
Non-current liabilities:		
Long-term borrowings	12,000	10,000
Current liabilities:		
Trade payables	7,800	8,000
Current tax	3,000	2,000
Total equity and liabilities	60,000	50,000

Statements of profit or loss for the years ended 31 May:

	2024 Sh."000"	2023 Sh. "000"
Revenue	428,000	572,000
Cost of sales	(316,720)	(394,680)
Gross profit	111,280	177,320
Distribution costs	(25,680)	(40,040)
Administrative expenses	(29,960)	(45,760)
Operating profit	55,640	91,520
Finance costs	(8,560)	(17,160)
Profit before tax	47,080	74,360
Income tax before expense	(6,420)	(11,440)
Profit for the year	40,660	62,920

Required:

(a) Common-size statements of profit or loss for the years ended 31 May 2023 and 31 May 2024. (10 marks)

(b) Common-size statements of financial position as at 31 May 2023 and 31 May 2024. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Outline **FOUR** objectives of financial statements. (4 marks)

(b) Explain **THREE** categories of cash flow items presented on the statement of cash flows of an entity. (6 marks)

(c) The following financial information was extracted from financial accounting records of Sterling Limited as at 30 April 2024:

- Ordinary share capital (Sh.5 par value) Sh.2,500,000
- Market value of ordinary shares Sh.12 per share
- Earnings attributable to equity holders Sh.1,875,000

Required:

Calculate the Price to Earnings (P/E) ratio for Sterling Limited. (2 marks)

(d) The following data applies to post employment defined benefit compensation scheme of Wanney Ltd.:

- Discount rate is 10% each year.
- Present value of obligation at the start of the year 2021 was Sh.1 million.
- Market value of plan assets at the start of the year 2021 was Sh.1 million.
- The following figures are relevant:

	2021 Sh. "000"	2022 Sh. "000"	2023 Sh. "000"
Current service cost	140	150	150
Benefits paid out	120	140	150
Contributions paid by entity	110	120	120
Present value of obligation at year end	1,200	1,650	1,700
Fair value of plan assets at year end	1,250	1,450	1,610

Additional information:

1. At the end of the year 2022, a division of the company was sold. As a result of this sale, a large number of employees of that division opted to transfer their accumulated pension entitlement to their new employers plan. Assets with a fair value of Sh.48,000 were transferred to the other company's plan and the actuary has calculated that the reduction in Wanney Ltd.'s defined benefit liability is Sh.50,000. The year-end valuations for the above details were carried out before this transfer was recorded.
2. At the end of the year 2023, a decision was taken to make a one-off additional payment to former employees currently receiving pensions from the plan. This was announced to the former employees before the year end. This payment was not allowed for in the original terms of the scheme. The actuarial valuation of the obligation in the above data includes the additional liability of Sh.40,000 relating to this additional payment.

Required:

Show how the reporting entity should account for this defined benefit plan in each of the years: 2021, 2022 and 2023. (8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following information relates to a non-cancellable lease agreement between XYZ leasing company and Mandy Ltd., a lessee:

- Inception date: 1 May 2022.
- Annual lease payment due at the beginning of each year, beginning with 1 May 2022: Sh.188,294.90.
- Bargain-purchase option price at the end of lease term: Sh.40,000.
- Lease terms: 5 years.
- Economic life of leased equipment: 10 years.
- Lessor's cost: Sh.650,000; fair value of asset at 1 May 2022, Sh.810,000.
- Lessor's implicit rate:10%; lessee's incremental borrowing rate is 10%.
- The lessee assumes responsibility for all executory costs.

Required:

From the perspective of XYZ leasing company:

(i) Determine the amount of lease receivable at the inception of the lease. (4 marks)

(ii) Calculate the total interest amount on the lease receivable for the five years lease term. (6 marks)

(b) The statements of financial position for XY Ltd. and AB Ltd. as at 31 December 2023 are provided below:

	XY Ltd.	**AB Ltd.**
	Sh."000"	**Sh. "000"**
Assets:		
Non-current assets:		
Property, plant and equipment	5,900	2,000
Investment in AB Ltd.	2,000	-
	7,900	2,000
Current assets	3,200	1,000
Total assets	11,100	3,000
Equity and liabilities:		
Equity:		
Share capital (Sh.1 equity share)	5,000	500
Retained earnings	3,800	2,000
Total equity	8,800	2,500
Non-current liabilities:		
Long-term borrowings	1,300	-
Current liabilities	1,000	500
Total liabilities	2,300	500
Total equity and liabilities	11,100	3,000

Additional information:

1. XY Ltd. acquired 80% of the equity share capital of AB Ltd. on 1 January 2021 for Sh.2,000,000 when the retained earnings of AB Ltd. were Sh.1,200,000. There have been no shares issued since the acquisition of AB Ltd.
2. At the date of the acquisition, the fair value of the net assets of AB Ltd. was the same as the book value with the exception of property, plant and equipment. The fair value of property, plant and equipment was Sh.400,000 higher than the book value. Property, plant and equipment had an estimated useful life of 10 years from the date of acquisition.
3. Non-controlling interest was valued at its fair value of Sh.450,000 at the date of the acquisition.
4. There has been no impairment of goodwill since the date of acquisition.
5. XY Ltd. purchased goods from AB Ltd. for Sh.200,000 during the year ended 31 December 2023 and 25% of these items remained in XY's Ltd. inventories at the year end. AB Ltd. earns a 20% profit margin on all sales.

Required:

Prepare a consolidated statement of financial position for the XY Ltd. Group as at 31 December 2023. (10 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 25 April 2024. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Statements of cash flows are useful additions to the financial statements of companies because it is recognised that accounting profit is not the only indicator of a company's performance.

In reference to the above statement, summarise **FOUR** advantages of cash flow statement. (4 marks)

(b) Analysing financial ratios is a widely used technique for judging a company's performance and financial position. It is expected that ratio analysis should be capable of providing a forecast of what is likely to happen in the future.

In relation to the above statement, explain **THREE** weaknesses of corporate failure prediction models. (6 marks)

(c) Describe how the discontinued operations are reported on the income statement. (4 marks)

(d) Oak Ltd. prepares its financial statements to 31 October. On 1 November 2021 they entered into a lease agreement for an item of plant on the following terms:

- The term of lease to be 5 years. The rentals was Sh.4,000,000 per annum payable in advance.
- The fair value of the asset is Sh.14,800,000.
- The interest rate implicit in the agreement is 18% per annum. Oak Ltd. has the option to acquire the plant for Sh.5,000 at the end of the lease contract.
- Oak Ltd. is responsible for all repairs and maintenance of the plant.
- The plant has an economic useful life of 6 years with nil residual value and the present value of the minimum lease payment is Sh.15,000,000.

Required:

Prepare the following for Oak Ltd.:

(i) Extract of the income statement for the year ended 31 October 2023. (2 marks)

(ii) Extract of the statement of financial position as at 31 October 2023. (4 marks)

(Total: 20 marks)

QUESTION TWO

On 1 October 2023, Hail Limited acquired 75% of Shower Limited's ordinary shares for an immediate cash payment of Sh.11.20 per acquired share. In addition, Hail Limited agreed to pay a further amount of Sh.5,600 million on 1 October 2024. Hail Limited's cost of capital is 12% per annum. Hail Limited has recorded the acquisition consideration as an investment in its financial statements.

On 1 October 2023, Hail Limited also acquired a 50% shareholding in Fall Limited having entered into a joint arrangement with co-investor for joint control over Fall Limited.

The draft statements of profit or loss and other comprehensive income of the three companies for the year ended 31 March 2024 are as follows:

	Hail Limited Sh."million"	Shower Limited Sh."million"	Fall Limited Sh."million"
Revenue	12,600	8,800	5,500
Cost of sales	(6,500)	(4,600)	(1,900)
Gross profit	6,100	4,200	3,600
Distribution costs	(1,900)	(1,020)	(620)
Administration expenses	(2,400)	(1,680)	(850)
Profit from operations	1,800	1,500	2,130
Finance costs	(200)	(120)	(150)
Profit before tax	1,600	1,380	1,980
Income tax expense	(450)	(380)	(580)
Profit for the year	1,150	1,000	1,400
Other comprehensive income:			
Revaluation on property	170	-	200
Total comprehensive income	1,320	1,000	1,600

The equity balances of Shower Limited as at 1 April 2023 comprised of:

	Sh."million"
Ordinary shares of Sh.10 par value	5,000
Share premium	1,000
Retained profit	5,200
	11,200

Additional information:

1. The fair values of the net assets of Shower Limited at the date of acquisition approximated their carrying values, with the exception of an item of plant whose fair value exceeded its carrying amount by Sh.200 million. This plant had an estimated remaining economic useful life of five (5) years at acquisition date. No fair value adjustments were necessary in respect of acquisition of investment in Fall Limited.
2. The group policy is to measure the non-controlling interests at their fair value at acquisition date. As at 1 October 2023, the fair value of the non-controlling interest in Shower Limited amounted to Sh.3,000 million.
3. During the post-acquisition period, Shower Limited sold inventory worth Sh.400 million to Hail Limited, reporting a gross profit margin of 20% on this sale. A quarter (¼) of these goods were still in the inventory of Hail Limited at 31 March 2024.
4. Impairment tests on 31 March 2024, revealed that no impairment was suffered.
5. Assume all incomes and expenses, gains and losses accrued evenly.

Required:

(a) Calculate the value of goodwill arising from acquisition of Shower Limited. (6 marks)

(b) Consolidated statement of profit or loss and other comprehensive income for the year ended 31 March 2024. (14 marks)

(Total: 20 marks)

QUESTION THREE

(a) Analysts' adjustments to a company's reported financial statements are sometimes necessary for example when comparing companies that use different accounting methods or assumptions.

In relation to the above statement, identify **FIVE** appropriate analysts adjustments to a company's financial statements to facilitate comparison with another company. (5 marks)

(b) Moses Otieno is an analyst and has gathered the following data relating to Kingley Ltd.:

	2023	2022	2021
Revenue (Sh."000")	72,448	66,487	55,781
Earnings before interest and tax (Sh."000")	6,270	4,710	3,609
Earnings before tax (Sh."000")	5,101	4,114	3,168
Net income (Sh."000")	4,038	3,345	2,576
Asset turnover	0.79	0.76	0.68
Asset/equity	3.09	3.38	3.43

Required:

(i) Analyse the trend in the return on equity (ROE). (3 marks)

(ii) Determine whether the firm can increase the ROE without operational changes. (2 marks)

(c) Palm Limited, a public limited entity had 7.2 million ordinary shares of Sh.10 par value and 2 million, 10% irredeemable preference shares of Sh.10 par value on 1 January 2023.

At the same date, Palm Limited also had in issue 10.5 million stock options which are exercisable at Sh.12 per share.

The average fair value per ordinary share during the year to 31 December 2023 was Sh.15.

Palm Limited's profit for the year ended 31 December 2023 from continuing operations amounted to Sh.20,705,000 while profit for the year ended 31 December 2022 was Sh.14,600,000.

The following share transactions took place during the year ended 31 December 2023:

1. On 1 March 2023, the company issued 1.8 million ordinary shares in a 1 for 4 rights issues at a price of Sh.12 per share when the market price per share on cum rights basis was Sh.15.
2. On 1 May 2023, Palm Limited issued 3 million ordinary shares at their full market price.
3. On 1 July 2023, the directors made a 1 for 5 bonus issue of ordinary shares, capitalising the retained profit.
4. On 1 October 2023, the company issued Sh.40 million, 12.5% convertible loan, which is convertible into 50 ordinary shares for every Sh.100 of the loan. No loan was converted during the year to 31 December 2023.
5. The basic income tax rate applicable to Palm Limited is 30%.
6. The directors declared and paid dividends to both classes of the shareholders.

Required:

(i) Calculate basic earnings per share for the year ended 31 December 2023. (6 marks)

(ii) Determine the diluted earnings per share for the year ended 31 December 2023. (4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) International Accounting Standard IAS 37 requires disclosure of the nature of a provision on contingent liability and an indication of the uncertainties about the amount or timing of any related outflow of economic benefits. Where necessary to provide adequate information. It also requires disclosure of the major assumption made about future events reflected in the amount of a provision.

In light of the above standard, explain **THREE** criteria to be met before a provision is recognised. (6 marks)

(b) Discuss **THREE** limitations of segment reporting requirements. (6 marks)

(c) The following balances were obtained from the books of Novida Limited as at 31 March 2024:

	Debit Sh."000"	**Credit Sh. "000"**
Building	700,000	
Provision for depreciation on buildings		105,000
Plant at cost	168,000	
Equity shares (Sh.100 par value)		280,000
Retained earnings (1 April 2023)		525,000
Revaluation reserves		70,000
Interim dividends paid	7,000	
Bank	730,800	
Revenue		1,222,900
Cost of sales	340,900	
Operating expenses	256,200	
	2,202,900	2,202,900

Additional information:

1. Novida Limited made a right issue on 1 October 2023 of 1 share for every 5 shares held at a price of Sh.150 each. The market price per share being Sh.200.
2. A general reserve to be created and Sh.42,000,000 be transferred from retained earnings.
3. A final dividend of 14% to be paid to equity shareholders.

Required:

Prepare statement of changes in equity for the year ended 31 March 2024. (8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Identify **TWO** kind of information that a financial analyst would be interested in from each of the following sources:

(i) Statement of financial position. (2 marks)

(ii) Auditors report. (2 marks)

(b) ABC Ltd. began operations in year 2022 and has provided the following information:

1. Pre-tax financial income for the year 2022 was Sh.100,000.
2. The tax rate applicable for year 2022 and future years is 30%.
3. Differences between the year 2022 income statement and tax return are listed below:
   - Warranty expense accrued for financial reporting purposes amount to Sh.5,000. Warranty deductions per the tax return amount to Sh.2,000.
   - Gross profit on construction contracts using the percentage of completion method for books amount to Sh.92,000. Gross profit on construction contracts for tax purposes amount to Sh.62,000.
   - Depreciation of property, plant and equipment for financial reporting purposes amount to Sh.60,000. Depreciation of these assets amount to Sh.80,000 for the tax return.
   - A Sh.3,500 fine paid for violation of pollution laws was deducted in computing pretax financial income.
   - Interest revenue earned on an investment in tax-exempt government bonds amount to Sh.1,400.
   - Taxable income is expected for the next few years.
   - In 2023, ABC Ltd. reported a pretax operating loss of Sh.100,000. There were no other temporary or permanent differences in tax and book income for the year 2023. ABC Ltd. expects to return to profitability in the year 2024.

Required:

(i) Compute the taxable income for the year 2022. (4 marks)

(ii) Calculate the deferred taxes as at 31 December 2022 that relate to the temporary differences described above. (2 marks)

(iii) Prepare the income tax expense section of the income statement beginning with income before income taxes for year 2022. (2 marks)

(iv) Determine the income tax expense for the year 2023. (2 marks)

(c) The following financial statement were prepared from the books of Moon Ltd. and Sun Ltd.

Moon Ltd. and Sun Ltd.
Income statements for the year ended 31 December 2023:

	Moon Ltd.		Sun Ltd.	
	Sh.“000”	**Sh.“000”**	**Sh.“000”**	**Sh.“000”**
Sales		350,000		224,000
Cost of sales				
Opening inventory	126,000		42,000	
Add purchases	294,000		168,000	
	420,000		210,000	
Less closing inventory	(154,000)	(266,000)	(70,000)	(140,000)
Gross profit		84,000		84,000
Expenses:				
Salaries and wages	19,600		14,000	

	Sh."000"	Sh."000"	Sh."000"	Sh."000"
Director's remuneration	14,000		14,000	
Other expenses	15,400	(49,000)	11,200	(39,200)
		35,000		44,800
Less transfer to general reserve	2,800		2,800	
Dividends	35,000	(37,800)	28,000	30,800
		(2,800)		14,000
Retained profit brought forward		21,000		11,200
Retained profit carried forward		18,200		25,200

Moon Ltd. and Sun Ltd.
Statement of financial position as at 31 December 2023:

	Moon Ltd.		Sun Ltd.	
Non-current assets:	**Sh."000"**	**Sh."000"**	**Sh."000"**	**Sh. "000"**
Equipment	28,000		7,000	
Depreciation on equipment	(11,200)	16,800	(2,800)	4,200
Motor vehicles	42,000		28,000	
Depreciation on motor vehicle	(16,800)	25,200	(9,800)	18,200
		42,000		22,400
Current assets:				
Inventories	154,000		70,000	
Trade receivable	87,500		28,000	
Bank	10,500	252,000	14,000	112,000
		294,000		134,400
Capital and liabilities:				
Issued share capital		140,000		70,000
Reserves:				
General reserves	9,800		16,800	
Retained profit	18,200	28,000	25,200	42,000
		168,000		112,000
Current liabilities:				
Trade payables	126,000	126,000	22,400	22,400
		294,000		134,400

Required:
Calculate the following ratios for each of the company:

(i) Stock turnover. (2 marks)

(ii) Debtor sales ratio (in months). (2 marks)

(iii) Creditor purchases ratio (in months). (2 marks)
(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 7 December 2023. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Explain the term "financial reporting framework" as used in financial statements analysis. (2 marks)

(b) Describe **THREE** analytical tools and techniques used in financial statements analysis. (6 marks)

(c) Analyse the recognition and measurement of non-current assets held for sale according to the International Financial Reporting Standards (IFRS) 5 – Non Current Assets Held for Sale and Discontinued Operations. (2 marks)

(d) Propose **FOUR** indicators of poor quality financial statements. (4 marks)

(e) Motown Ltd. sponsors a defined benefit pension plan. The corporation's actuary provides the following information about the plan:

	1 January 2022	**31 December 2022**
Defined benefits obligation	Sh.2,500,000	Sh.3,300,000
Plan assets (fair value)	Sh.1,700,000	Sh.2,620,000
Discount rate		10%
Pension asset/liability	Sh.800,000	?
Service cost for year 2022		Sh.400,000
Contributions (funding in year 2022)		Sh.700,000
Benefits paid in year 2022		Sh.200,000

Required:

Calculate the amount of other comprehensive income (gain/loss) as at 31 December 2022. Assume that on 1 January 2022 the balance was zero. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain "income smoothing patterns" as an earnings management strategy. (2 marks)

(b) Analyst forecasts, reports and recommendations along with other alternative information sources are a major competitor for accounting information.

Required:

Explain **THREE** advantages offered by these alternative sources of information for analysis. (6 marks)

(c) The following information relates to Kiwi Ltd.:

Kiwi Ltd.
Income statement for the year ended 31 December 2022 and 31 December 2021

	2022 Sh.	2021 Sh.
Sales	1,782,254	1,636,298
Cost of goods sold and operating expenses	(1,598,679)	(1,473,293)
Operating profit	183,575	163,005
Interest expense	(20,843)	(21,825)
Pretax profit	162,732	141,180
Tax expense	(58,584)	(52,237)
Net income	104,148	88,943

Kiwi Ltd.
Statement of financial position as at 31 December 2022 and 31 December 2021

	2022 Sh.	2021 Sh.
Assets:		
Cash	71,456	115,397
Marketable securities	43,854	38,008
Accounts receivable (net)	182,859	177,538
Inventories	256,838	204,362
Total current assets	555,097	535,305
Investments in unconsolidated subsidiaries	62,390	33,728
Marketable securities	56,997	5,931
Property, plant and equipment (net)	1,633,458	1,539,221
Goodwill	6,550	6,550
Total non-current assets	1,759,395	1,585,430
Total assets	2,314,492	2,120,735
Liabilities:		
Notes payable	13,734	7,850
Accounts payable	155,482	138,662
Taxes payable	13,256	24,370
Current maturities of long term debt	33,822	30,440
Current liabilities	216,294	201,322
Long term debt	473,507	507,329
Pension liabilities	852,237	743,779
Total long term liabilities:	1,325,744	1,251,108
Equity:		
Common stock	413,783	413,783
Additional paid in capital	19,208	19,208
Retained earnings	540,901	436,752
Treasury stock	(201,438)	(201,438)
Total stockholders' equity	772,454	668,305
Total liabilities and equity	2,314,492	2,120,735

Required:
Calculate the following for the year 2022:

(i) Return on Net Operating Assets (RNOA). (4 marks)

(ii) Return on common equity (ROCE) as a function of return on Net Operating Assets (NOA), financial leverage and spread. (4 marks)

(d) Wyatt Ltd. has a deferred tax asset account with a balance of Sh.150,000 at the end of year 2021 due to a single cumulative temporary difference of Sh.375,000. At the end of year 2022, this same temporary difference has increased to a cumulative amount of Sh.500,000. Taxable income for year 2022 is Sh.850,000. The tax rate is 30% for all years.

Required:
Determine and record income tax expense, deferred income taxes and income taxes payable for year 2022, assuming that it is probable that the deferred tax asset will be realised. (4 marks)

(Total: 20 marks)

QUESTION THREE

On 1 October 2021, Hunters Limited acquired an 80% controlling interest in Spear Limited when retained earnings of Spear Limited amounted to Sh.230 million. The acquisition consideration comprised of an immediate cash payment of Sh.404 million and a share exchange on the basis of one (1) ordinary share of Hunters Limited for every two (2) ordinary shares acquired in Spear Limited. The fair value of Hunters Limited's shares at 1 October 2021 was Sh.20 per share. No accounting entries have been made in respect of the share exchange consideration.

The following draft statements of financial position relate to Hunters Limited and Spear Limited as at 30 September 2023:

Assets:	**Hunters Limited Sh."000"**	**Spear Limited Sh."000"**
Non-current assets:		
Property, plant and equipment	1,196,500	544,800
Investment	482,000	
	1,678,500	544,800
Current assets:		
Inventory	107,200	120,000
Trade receivables	135,900	70,700
Cash and cash equivalents	12,600	11,700
Total assets	1,934,200	747,200
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.10 par value	610,000	200,000
Retained earnings	495,100	350,000
Total equity	1,105,100	550,000
Non-current liabilities:		
10% loan stocks	450,000	70,000
Current liabilities:		
Trade payables	287,300	91,900
Current tax	91,800	35,300
Total equity and liabilities	1,934,200	747,200

Additional information:

1. The fair values of Spear Limited's net assets approximated their carrying values with the exception of an item of plant whose fair value exceeded its carrying amount by Sh.50 million. The plant had a remaining useful life of five years on 1 October 2021.
2. The group policy is to measure the non-controlling interests at their proportionate share of net assets in subsidiaries at the date of acquisition.
3. During the year ended 30 September 2023, Spear Limited sold goods worth Sh.100 million to Hunters Limited and reported a gross profit margin of 20% on this sale. Three quarters of the goods had been sold to third parties by Hunters Limited as at 30 September 2023.
4. On 1 October 2021, Hunters Limited also acquired 25% shareholding in Arrow Limited for Sh.78 million paid in cash. The retained earnings of Arrow Limited as at 30 September 2021 and 2023 were Sh.228 million and Sh.372 million respectively.
5. Impairment tests on 30 September 2023 revealed that goodwill on acquisition of Spear Limited was impaired to the extent of 10%. Investment in Arrow Limited was not impaired.

Required:

(a) Determine the value of investment in Arrow Limited as at 30 September 2023. (2 marks)

(b) Calculate the value of goodwill arising on acquisition of Spear Limited. (6 marks)

(c) Prepare a consolidated statement of financial position as at 30 September 2023. (12 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Highlight **FOUR** objectives of benchmarking to a financial analyst. (4 marks)

(b) Explain **THREE** steps followed while conducting financial statements analysis. (6 marks)

(c) The shareholders' equity section of the statement of financial position for Kaunda Ltd. included the following accounts as at 31 December 2020.

Shareholder' equity	**Sh."million"**
Paid in capital:	
Common stock 120 million shares at Sh.1 par value	120
Paid in capital in excess of par	836
Retained earnings	2,449
Total shareholders' equity	3,405

During the year 2021, the following transactions affected the stock of the firm:

1. On March 2021, the firm issued 10 million of its 9.2% preferred shares, Sh.1 par value per share for Sh.44 per share.
2. On November 2021, 1 million common share, Sh.1 par value per share, were issued in exchange for customised machine. The firm stock was listed at Sh.10 per share.
3. On November 2021, 1 million of the common shares and Sh.1 million preferred shares were sold for Sh.60 million. The preferred shares had not traded since March and their market value was uncertain.
4. The net income for 2021 was Sh.400 million and preferred shareholders were paid Sh.1 million cash dividends.

During year 2022, the firm reacquired common shares and sold shares in two separate transactions later that year as follows:

5. The firm purchased 6 million shares at Sh.10 per share.
6. The firm sold 2 million shares at Sh.12 per share.
7. The firm sold 2 million shares at Sh.7 per share.
8. The net income for year 2022 was Sh.400 million and preferred shareholders were paid Sh.1 million cash dividends.

Required:
Prepare the shareholders' equity section of the firm's statement of financial position as at the years ended 31 December 2021 and 31 December 2022 assuming the shares traded in 2022 are considered to be treasury stock. (10 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain the term "DuPont analysis" as used in financial statement analysis. (2 marks)

(b) Discuss **THREE** challenges currently facing financial analysts in your country while undertaking financial statements analysis. (6 marks)

(c) Gerand Karim is a financial analyst who is following Tala Ltd., and has used the following proforma income statement and statement of financial position for year ended 31 October 2023 and is projecting the firm's earnings per share for year ending 31 October 2024 and the statement of financial position for further analysis. He makes the following assumptions for year 2024 compared with year 2023:

1. Unit sales will rise by 7% and prices will remain the same.
2. Synergies from acquisitions will add an additional Sh.200 million to sales.
3. Gross profit margin as a percentage of net sales will improve by 1.5 percentage points.
4. Selling, general and administrative expenses as a percentage of net sales will improve by 0.7 percentage points.
5. Depreciation expense will rise by 5 per cent.
6. Goodwill amortisation will rise by Sh.10 million.
7. Long term debt expense will remain the same.
8. Interest rates will decrease, reducing interest expense by Sh.10 million.
9. The income tax rate will rise by 0.5%.
10. Average share outstanding will remain the same.
11. Dividend per share will rise by 10%.
12. The average collection period of accounts receivable will decrease from 53 days to 48 days based on year-end accounts receivable.
13. Average days inventory will decrease from 92 to 80 based on year-end inventory.

Selected projected items of the year 2024 statement of financial position are provided below:

	Sh."million"
Net property, plant and equipment	1,100
Intangibles	1,435
Current liabilities	531
Long-term debt	1,250

The income statement for year ended 31 October 2023 is provided below:

	(in Sh."million", except per share) **Sh."million"**
Net sales	6,000
Cost of goods sold	(2,850)
Gross profit	3,150
Selling, general and administrative	(1,780)
Depreciation	(280)
Goodwill amortisation	(25)
Operating income	1,065
Interest expense	(170)
Income before taxes	895
Income tax	(300)
Net income	595
Diluted EPS	2.29
Average shares outstanding (millions)	260
Dividend per share	0.64

The statement of financial position as at 31 October 2023:

	Sh."million"
Net property, plant and equipment	1,050
Intangibles	1,400
Inventories	720
Accounts receivable	870
Cash	550
Total assets	4,590
Liabilities and equity:	
Stockholders' equity	2,840
Current liabilities	500
Long-term liabilities	1,250
Total liabilities	1,750
Total liabilities and equity	4,590

Assume 365 days in a year.

Required:
Prepare the following for the year ending 31 October 2024:

(i) Projected income statement. (6 marks)

(ii) Projected statement of financial position. (6 marks)
(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 24 August 2023. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Distinguish between "top-down approach" and "bottom-up approach" to analysing financial statements. (4 marks)

(b) Explain **THREE** indicators of measuring quality of earnings of a company. (6 marks)

(c) The following forecast information relates to Venus Ltd. for nine months up to March 2024:

Forecast income statement for the three quarters ending 31 March 2024 is as follows:

	30 September 2023 Sh."million"	**31 December 2023 Sh."million"**	**31 March 2024 Sh."million"**
Sales	250	300	350
Cost of sales	(200)	(240)	(280)
Gross profit	50	60	70
Depreciation	(3)	(20)	(4)
Administration, selling and distribution expenses	(37)	(40)	(42)
Forecast net income	10	0	24

Extracts of the forecasted statements of financial position as at:

	30 June 2023 Sh."million"	**30 September 2023 Sh."million"**	**31 December 2023 Sh."million"**	**31 March 2024 Sh."million"**
Debit balance:				
Tangible fixed asset at cost	360	240	480	480
90 days deposit at cost	15	5	5	10
Inventory at cost	40	30	40	55
Trade receivables	50	65	75	80
Cash at bank and in hand	80	-	-	-
Credit balance:				
10% debenture	-	-	-	50
Trade payable	80	120	140	150
Taxation	8	-	-	-

Additional information:

1. Sale of tangible fixed assets in September 2023 will be expected to realise Sh.12 million in cash.
2. Administration, selling and distribution expenses are expected to be settled during the months in which they will be incurred.
3. Venus Ltd. includes liquid resources as term deposits of less than one year.
4. The directors have proposed that a dividend of Sh.15 million to be paid on 31 August 2023.

Required:

A forecast statement of cash flows for the nine months ending 31 March 2024. (10 marks)

(Total: 20 marks)

QUESTION TWO

(a) Analyse how climate change could affect the following areas of financial statements:

(i) Property, plant and equipment (PPE). (2 marks)

(ii) Impairment. (2 marks)

(b) Comparative financial statements are commonly used for financial analysis for decision making, however they may have some limitations.

Required:
Explain **THREE** limitations of comparative financial statements while calculating ratios. (6 marks)

(c) Platinum operates a defined benefit pension plan for its employees. As at 1 April 2022, the fair value of the pension plan assets was Sh.2,700,000 and the present value of the pension plan obligations was Sh.3,000,000.

The service cost for the year ended 31 March 2023 was Sh.650,000. On 1 April 2022, the pension plan was amended to offer additional benefits to members resulting in past service costs of Sh.200,000. The relevant discount rate for the year ended 31 March 2023 was estimated at 5% and Platinum paid Sh.950,000 in contributions to the plan. The pension plan paid Sh.320,000 to retired members in the year ended 31 March 2023.

As at 31 March 2023, the fair value of the pension plan assets was Sh.3,600,000 and the present value of the pension plan obligations was Sh.3,800,000.

Required:
Calculate the following in respect of Platinum pension plan:

(i) The expense in the income statement for the year ended 31 March 2023. (2 marks)

(ii) The amounts that will be included in other comprehensive income for the year ended 31 March 2023. (6 marks)

(iii) The net pension asset or obligation (stating which) that will be included in the statement of financial position as at 31 March 2023. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain the term "earnings management". (2 marks)

(b) Litmus Ltd. operates in hydro-chemical sector. In order to sell its product globally, it has been advised by global markets consultant Ltd. to enter into business combination with Catalyst Ltd. which is its competitor. In order to achieve this objective, Litmus Ltd. acquired all of the ordinary share capital of Catalyst Ltd. by way of a share exchange on 1 January 2023.

The summarised financial statements of both companies for the year ended 30 June 2023 are as follows:

Income statement for the year ended 30 June 2023:

	Litmus Ltd.	**Catalyst Ltd.**
	Sh."000"	**Sh."000"**
Sales	24,000	20,000
Cost of sales	(16,600)	(11,800)
Gross profit	7,400	8,200
Operating expenses	(1,600)	(1,000)
Profit before tax	5,800	7,200
Taxation	(2,000)	(3,000)
Profit for the year	3,800	4,200

Statement of financial position as at 30 June 2023:

	Litmus Ltd. Sh."000"	Catalyst Ltd. Sh."000"
Property, plant and equipment	64,000	35,000
Investments	-	12,800
Inventory	22,800	23,600
Trade receivables	16,400	24,200
Bank	500	200
	103,700	95,800
	Sh."000"	**Sh."000"**
Equity and liabilities:		
Ordinary shares of Sh.1 each	20,000	12,000
Share premium	4,000	2,400
Retained earnings	57,200	42,700
8% loan note	5,000	18,000
Current liabilities:		
Trade payables	15,300	17,700
Corporate tax	2,200	3,000
	103,700	95,800

Additional information:

1. Litmus Ltd. issued five of its own shares for every four shares in Catalyst Ltd.
2. The market value of Litmus Ltd.'s share on 1 January 2023 was Sh.6 each.
3. The share issue has not yet been recorded in the books of Litmus Ltd.
4. The fair value of Catalyst Ltd.'s investment was Sh.5 million in excess of its book value at the date of acquisition. The fair values of Litmus Ltd.'s other net assets were equal to their book values.
5. Goodwill was reviewed at 30 June 2023 and an impairment cost of Sh.3 million is to be recognised.
6. No dividends have been paid by either company.

Required:
Prepare the following for the Litmus Ltd. Group:

(i) Consolidated statement of profit or loss for the year ended 30 June 2023. (6 marks)

(ii) Consolidated statement of financial position as at 30 June 2023. (12 marks)

(Total: 20 marks)

QUESTION FOUR

(a) The role of a financial statement analyst is to use financial reports prepared by an organisation together with other information, to evaluate the past, present and future performance of an organisation for the purpose of making investment, credit and other decisions.

In relation to the above statement, outline **FOUR** types of economic decisions that a financial analyst could make from the analysis of financial statements of an organisation. (4 marks)

(b) The profit after tax of Baragoh Ltd. for the year ended 30 September 2022 was Sh.15 million. As at 1 October 2021, the company had in issue 36 million equity shares and Sh.10 million 8% convertible loan note. The loan note will mature in year 2023 and will be redeemed at par or converted to equity shares on the basis of 25 shares for each Sh.100 of loan note at the loan note holder's option. On 1 January 2022, Baragoh Ltd. made a fully subscribed rights issue of one new share for every four shares held at a price of Sh.2.80 each. The market price of the equity shares of Baragoh Ltd. immediately before the issue was Sh.3.80. The earnings per share (EPS) reported for the year ended 30 September 2021 was Sh.0.35. Baragoh income tax rate is 25%.

Required:
Calculate the following for the year ended 30 September 2022:

(i) Basic earnings per share (EPS) for Baragoh Ltd. (including comparatives). (4 marks)

(ii) Diluted earnings per share (EPS) (comparatives not required) that would be disclosed for the year ended 30 September 2022. (4 marks)

(c) The following financial statements were extracted from the books of Alpha Ltd. and Omega Ltd. for the year ended 31 March 2023:

Statement of profit or loss for the year ended 31 March 2023:

	Alpha Ltd. Sh."million"	**Omega Ltd.** Sh."million"
Revenue	1,699.815	2,058.96
Cost of sales	(1,171.045)	(1,397.135)
Gross profit	528.77	661.825
Less: Operating expenses	(354.775)	(469.89)
Net profit	173.995	191.935
Less: Finance expenses	(22.31)	(31.625)
Profit before tax	151.685	160.31
Tax	(36.8)	(40.02)
Profit for the year	114.885	120.29

Statement of financial position as at 31 March 2023:

	Alpha Ltd. Sh."million"	**Omega Ltd.** Sh."million"
Non-current assets		
Land and building	414.00	586.5
Furniture and fittings	100.65	104.88
	514.05	691.38
Current assets:		
Inventories	680.80	463.45
Trade receivables	202.86	370.185
Bank	97.29	105.34
	980.95	938.975
Total assets	1,495	1,630.355
Capital and liabilities:		
Capital:		
Ordinary share capital	368.00	287.50
Retained earning	422.74	718.29
	790.74	1,005.79
Non-current liabilities:		
Bank loan	218.50	287.50
Current liabilities:		
Trade payable	467.36	317.055
Tax	18.40	20.010
	485.76	337.065
Total capital and liabilities	1,495	1,630.355

The following additional information is available:

1. All purchases and sales were on credit.
2. Alpha Ltd. and Omega Ltd. had announced their intention to pay dividend Sh.155.25 million and Sh.109.25 million respectively for the year ended 31 March 2023.
3. The market value per share in Alpha Ltd. and Omega Ltd. at the end of the year were Sh.7.50 and Sh.9.40 respectively.

Required:
For each company, calculate two ratios that are concerned with each of the following aspects:

(i) Profitability. (2 marks)

(ii) Liquidity. (2 marks)

(iii) Gearing. (2 marks)

(iv) Efficiency. (2 marks)
(Total: 20 marks)

QUESTION FIVE

(a) Identify **TWO** challenges faced by a financial analyst when interpreting a particular firm's restructuring charge. (2 marks)

(b) Describe **TWO** reasons why the statement of cash flow as a complement to the statement of financial position and the statement of profit or loss is an informative statement for analysts. (4 marks)

(c) The following figures have been calculated from the financial statements (including comparatives) of Best Wishes Ltd. for the year ended 31 March 2023:

1. Increase in profit after taxation 80%.
2. Increase in (basic) earnings per share (BEP) 5%.
3. Increase in (diluted) earnings per share (DEPS) 2%.

Required:

With reference to the above information, explain **TWO** reasons why measures of earnings (profits) growth for the same company over the same period can give apparently differing impressions. (4 marks)

(d) The following information has been extracted from the books of Maridadi Ltd. for the year ended 30 June 2023:

		Sh.“000”
Ordinary shares (900,000 ordinary shares of Sh.500 each)		450,000
Retained earnings at the beginning as ordinarily reported		257,500
250,000, 12% preference shares of Sh.500 each		125,000
Dividends		40,000
Gain on disposal of property, plant and equipment		52,500
Prior period adjustment (credit to retained earnings)		12,500
Cost of goods sold		950,000
Income tax expense (savings):	Continuing operations	80,000
	Extraordinary gains	25,000
	Discontinued operations	20,000
Selling expenses		195,000
Sales revenue		1,550,000
Finance expense		75,000
Extra ordinary gain		65,000
Income for discontinued operations		50,000
Loss due to court cases		27,500
General expenses		155,000

Assume corporation tax rate of 30%.

Required:

(i) A single step statement of profit or loss (with all revenues and gains grouped together) for the year ended 30 June 2023. (6 marks)

(ii) Statement of retained earnings for the year ended 30 June 2023. (4 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 27 April 2023. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Distinguish between "net free cash flow" and "free cash flow". (2 marks)

(b) Summarise **TWO** categories of accounting changes. (2 marks)

(c) Extracts from the financial statements of Molo Ltd. is provided below:

Statement of profit or loss for years ended 31 December:

	2021 (Sh."million")	2022 (Sh."million")
Revenue	8.0	9.5
Operating profit (loss)	(2.0)	1.9
Interest payable	(2.4)	(1.5)
Profit/(loss) before taxation	(4.4)	0.4

There was no charge for taxation and no dividends were paid in respect of any of these two years.

Statement of financial position as at 31 December:

	2021	2022
Assets:	**(Sh."million")**	**(Sh."million")**
Non-current assets:		
Property, plant and equipment at cost	23.9	24.0
Depreciation	(12.0)	(14.0)
	11.9	10.0
Current assets:		
Inventories	3.5	3.8
Trade receivables	2.6	4.1
	6.1	7.9
Total assets	18.0	17.9
Equity and liabilities:		
Equity:		
Ordinary shares	1.0	1.0
Reserves	3.0	3.4
	4.0	4.4
Non-current liabilities:		
Borrowings-loan notes	8.2	7.4
Current liabilities:		
Trade payables	1.7	1.9
Short-term borrowings (all bank overdraft)	4.1	4.2
	5.8	6.1
Total equity and liabilities	18.0	17.9

Required:
Calculate for each year, the following ratios for Molo Ltd.:

(i) Return on capital employed (ROCE) ratio. (2 marks)

(ii) Acid test ratio. (1 mark)

(iii) Trade receivables settlement period ratio. (1 mark)

(iv) Interest coverage ratio. (1 mark)

(v) Gearing ratio. (1 mark)

(vi) Analyse the above ratios for the management of Molo Ltd. (4 marks)

(d) In relation to qualitative characteristics of financial reporting information:

(i) Outline **TWO** fundamental qualitative characteristics of useful financial information. (2 marks)

(ii) Explain **TWO** enhancing qualitative characteristics of useful financial information. (4 marks)
(Total: 20 marks)

QUESTION TWO

(a) Distinguish between "defined contribution plan" and "defined benefit plan". (4 marks)

(b) Explain the impact of the following assumptions used on the defined benefit obligations and period expenses:

(i) Discount rates. (2 marks)

(ii) Return on plan assets. (2 marks)

(c) Identify **FOUR** purposes of financial statement analysis. (4 marks)

(d) At 31 December 2022, the financial statements for Mwihukoh Ltd. included the following:

- The net income for the year 2022 (including a net of tax loss from discontinued operations of Sh.10 million) was Sh.180 million
- Outstanding shares on 1 January 2022 (Sh.1 par value) was 44 million
- The share price at 1 January 2022 was Sh.25 and Sh.28 at the end of the year 2022.

Additional information:

1. At 1 January 2022, Sh.200 million of 8% convertible loan notes were outstanding. The loan notes were converted on 1 April 2022 into 16 million ordinary shares.
2. An agreement with the company executives calls for the issuance of up to 12 million of additional ordinary shares in the year 2023 and 2024 based on Mwihukoh's net income in the two years. Executives will receive 2 million ordinary shares at the end of each of those two years if the company's share price is at least Sh.26 and another 4 million shares each year if the share price is at least Sh.29.50.
3. The corporate tax rate is 30%.

Required:
Compute the following for the year ended 31 December 2022:

(i) Basic earnings per share. (3 marks)

(ii) Diluted earnings per share. (5 marks)
(Total: 20 marks)

QUESTION THREE

Perkah Ltd. operates in Agro-business sector. In order to sell its products globally, it has been advised by Smart Marketing Consultant Ltd. to enter into business combination with Avocado Ltd. which is its competitor. In order to achieve this objective, Perkah Ltd. acquired all of the ordinary shares capital of Avocado Ltd. by way of share exchange on 1 October 2022.

The summarised financial statements of both companies for the year ended 31 March 2023 are as follows:

Statement of profit or loss for the year ended 31 March 2023:

	Perkah	**Avocado**
	Sh.“000”	**Sh.“000”**
Sales	24,000	20,000
Cost of sales	(16,600)	(11,800)
Gross profit	7,400	8,200
Operating expenses	(1,600)	(1,000)
Profit before tax	5,800	7,200
Corporate tax	(2,000)	(3,000)
Profit for the year	3,800	4,200

Statement of financial position as at 31 March 2023:

Assets:	**Sh.“000”**	**Sh.“000”**
Property, plant and equipment	64,000	35,000
Investment	-	12,800
Inventory	22,800	23,600
Trade receivables	16,400	24,200
Bank	500	200
	103,700	95,800
Equities and liabilities:		
Ordinary share Sh.1 par value	20,000	12,000
Share premium	4,000	2,400
Retained earnings	57,200	42,700
8% loan note	5,000	18,000
Trade payables	15,300	17,700
Taxation	2,200	3,000
	103,700	95,800

Additional information:

1. Perkah Ltd. issued five (5) of its own ordinary shares for every four (4) ordinary shares of Avocado Ltd. on 1 October 2022.
2. The market value of Perkah Ltd. ordinary shares on 1 October 2022 was Sh.6 each. The shares issue has not yet been recorded in Perkah Ltd.’s books.
3. The fair value of Avocado Ltd.’s investment was Sh.5 million in excess of its book value at the date of acquisition.
4. The fair value of Perkah Ltd. other assets were equal to their book value.
5. Goodwill was on 31 March 2023 valued at Sh.27 million.
6. No dividends have been paid by either company.
7. Incomes and expenses accrued evenly throughout the year.

Required:

Applying International Accounting Standards (IAS) 1 – Presentation of financial statement, prepare the following:

(a) Consolidated statement of profit or loss for the year ended 31 March 2023. (6 marks)

(b) Consolidated statement of changes in equity for the year ended 31 March 2023. (4 marks)

(c) Consolidated statement of financial position as at 31 March 2023. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Marketing benchmarks are standard measurements that are used to compare company's results to those of their competitors or industry.

With reference to the above statement, explain **FOUR** industry metrics that reflects on company's performance. (8 marks)

(b) The following information were obtained from the accounting records of Ramayan Ltd. for the year ended 31 March 2023:

Statement of profit or loss for the year ended 31 March 2023

	Sh."000"	Sh."000"
Sales		837,600
Cost of goods sold		(624,000)
Gross profit		213,600
Other incomes:		
Interest income received		7,200
Gain on sale of investments		14,400
		235,200
Less expenses:		
Operating expenses	132,000	
Depreciation	44,400	
Interest expense paid	27,600	
Loss on sale of plant	3,600	(207,600)
		27,600
Income tax		(8,400)
Net profit after tax		19,200

Comparative statement of financial position as at:

	31 March 2023 Sh."000"	31 March 2022 Sh."000"
Non-current assets:		
Plant and equipment	858,000	606,000
Less: Accumulated depreciation	(123,600)	(81,600)
	734,400	524,400
Investments	138,000	152,400
Current assets:		
Inventory	172,800	132,000
Accounts receivable	56,400	66,000
Cash	55,200	18,000
Prepaid expenses	1,200	6,000
	1,158,000	898,800
Financed by:		
Share capital	558,000	378,000
Reserves and surplus	168,000	158,400
Bonds	354,000	294,000
Current liabilities:		
Accounts payable	60,000	51,600
Accrued liabilities	14,400	10,800
Income taxes payable	3,600	6,000
	1,158,000	898,800

Additional information:

The following transactions took place during the year ended 31 March 2023:

1. Purchased investments for Sh.93,600,000.
2. Sold investments for Sh.122,400,000.
3. Purchased plant and equipment for Sh.144,000,000.
4. Sold a plant that cost Sh.12,000,000 with accumulated depreciation of Sh.2,400,000 for Sh.6,000,000.
5. Issued Sh.120,000,000 bonds at face value in an exchange for a plant on 31 March 2023.
6. Repaid Sh.60,000,000 bonds at face value at maturity.
7. Issued 15,000,000 ordinary shares at Sh.12 each.
8. Paid cash dividends for Sh.9,600,000.

Required:

A cash flow statement in accordance with the "International Accounting Standard 7" – Statements of Cash Flows using indirect method for the year ended 31 March 2023. (12 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Highlight **SIX** limitations of financial statement analysis. (6 marks)

(b) Haboh Ltd.'s sales for the year 2022 was Sh.4,022,000. Accounts receivable amounted to Sh.655,000 at the beginning of year 2022 and Sh.612,000 at the end of year 2022. The firm has generated a compound annual sales growth rate of 13% over the past two years.

A financial analyst assumes that:

1. The company's sales will continue to grow at 13% each year for the next five years.
2. The accounts receivable turnover for the next five years will equal the ratio computed for the year 2022.

Required:

(i) Calculate the accounts receivable turnover for the year 2022 using the average balance method. (1 mark)

(ii) Project the amount of accounts receivable at year end 2023 through year 2027. (3 marks)

(c) Financial shenanigans and red flags is a real threat to any business today.

Highlight **SIX** sources that could be used when investigating red flags and financial shenanigans. (6 marks)

(d) Riziki Ltd. purchased an item of plant for Sh.2 million on October 2019. The item had an estimated useful life of eight years and estimated residual value of Sh.400,000.

Additional information:

1. The plant is depreciated on a straight line basis.
2. The tax authorities do not allow depreciation as a deductible expenses, instead a tax expenses of 40% of the cost of this type of an asset can be claimed against taxable income in the year of purchase and 20% per annum (on a reducing balance basis) of its tax base thereafter.
3. The corporate rate is 25%.

Required:

In respect of the above item of plant, calculate the amount of deferred tax charged or credited in Riziki Ltd.'s statement of comprehensive income for the year to 30 September 2022. (4 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 8 December 2022. Afternoon Paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) With reference to International Accounting Standards (IAS) 31, Interest in Joint Ventures, describe **TWO** types of joint ventures. (4 marks)

(b) Analyse the accounting treatment of a material prior period error. (4 marks)

(c) Pluto Ltd. leases out a machine to Jupiter Ltd. under finance lease agreement. The agreement states that the lease period will be for five years starting on 1 January 2019. Rent payable is Sh.3,600,000 per annum (in arrears).

Jupiter Ltd. has the right to continue the lease after the five years are over to an indefinite period at a nominal rent. The cash price of the machine as at 1 January 2019 was Sh.13,646,400. The interest implicit in the lease is 12%.

Required:

(i) Applying International Accounting Standards (IAS) 17- Leases, record the above accounting transactions in Pluto Ltd. books. (7 marks)

(ii) Prepare receipts schedule. (5 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain **TWO** benefits of analysing a set of financial statements in the context of market efficiency. (4 marks)

(b) Ruenzori Ltd. uses zero coupon notes to raise capital. On 1 January 2022, Ruenzori Ltd. borrowed money from a bank by issuing a Sh.100 million promissory note to the bank. The note matures in five years on 1 January 2027 and pays 5% interest once a year on 1 January. The bank transfers Sh.95.79 million to Ruenzori Ltd.

Required:

(i) Calculate the total interest cost on the note. (2 marks)

(ii) Calculate the effective rate of return on the loan. (4 marks)

(c) The following is an extract of income statement for Raymond Ltd. for the year ended 31 December 2020 and 31 December 2021:

	2020	**2021**
	Sh.“000”	**Sh.“000”**
Sales	8,296	8,871
Cost of goods sold	(5,890)	(6,290)
Selling and administrative expenses	(1,788)	(1,714)
Operating income before taxes	618	867

An analyst decides to estimate the variable cost as a percentage of sales for a particular cost by dividing the amount of the change in the cost item between two years by the amount of change in sales for those two years.

The analyst then multiplies total sales by the variable cost percentage to determine the total variable cost. Subtracting the variable cost from the total cost yields the fixed cost component for that particular cost item. Raymond Ltd. expects sales to grow by 12% in year 2022.

Required:

(i) Determine sales, cost of goods sold, selling and administrative expenses and operating income before income taxes for the year 2022. (8 marks)

(ii) Compute the ratio of operating income before income taxes to sales for year 2022. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Outline **FOUR** motivations for earnings manipulation by a firm. (4 marks)

(b) List **FOUR** limitations of a cash flow statements. (4 marks)

(c) Explain how the income taxes affect the principal financial statements. (2 marks)

(d) The following information was extracted from the books of Bingo Ltd. for the year ended 31 March 2022:

		Sh."million"
Sales:	Food Products	6,780
	Plastics	750
	Pharmaceuticals	414
	Others	194.4
Expenses:	Food Products	4,002
	Plastics	510
	Pharmaceuticals	266.4
	Others	240
Other items:		
General operating expenses		(674.4)
Income from investment		158.4
Interest expenses		(78)
Identifiable assets:		
	Food Products	8,784
	Plastics	1,584
	Pharmaceuticals	1,260
	Others	798
General assets		866.4

Additional information:

1. Inter-segment sales for the year ended 31 March 2022 were as follows:

	Sh."million"
Food Products	66
Plastics	86.4
Pharmaceuticals	25.2
Others	8.4

2. Operating profits includes Sh.39.6 million on inter-segment sales.
3. Information about inter-segment expenses is not available.

Required:

Prepare segmental financial information in accordance to the International Financial Reporting Standards (IFRS) 8, Operating Segments. (10 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Discuss **THREE** criticisms of Earnings Per Share (EPS) as a measure of profitability. (6 marks)

(b) Paul Mwangi gathered the following information relating to the consumer loan credit quality profile:

As at 31 December:	**2021**	**2020**	**2019**
	Sh.“000”	**Sh.“000”**	**Sh.“000”**
Strong credit quality	338,948	327,345	320,340
Good credit quality	52,649	54,515	54,050
Satisfactory credit quality	51,124	55,311	56,049
Substandard credit quality	23,696	24,893	27,525
Past due but not impaired asset	2,823	2,314	2,058
Impaired asset	8,804	9,345	10,235
Total gross amount	478,044	473,723	470,257
Impairment allowance	(5,500)	(4,500)	(4,000)
Total:	472,544	469,223	466,257

Required:

Analyse the factors affecting the trend in impairment allowances. (4 marks)

(c) Agano Ltd. operates a defined benefit pension plan. The following financial data relates to the scheme for the past three years ended 31 March: 2020, 2021 and 2022.

Year ended 31 March:	**2020**	**2021**	**2022**
Discount rate at the beginning of the year	10%	9%	8%
Expected rate of return on plan assets	12%	11%	10%
	Sh.“000”	**Sh.“000”**	**Sh.“000”**
Current service cost	130,000	140,000	150,000
Benefit paid	150,000	180,000	190,000
Contribution paid	90,000	100,000	110,000
Present value of obligation as at 31 March:	1,100,000	1,380,000	1,408,000
Fair value of plan assets as at 31 March:	1,190,000	1,372,000	1,188,000

The present value of obligations and the fair value of plan assets were both Sh.1,000,000,000 each as at 1 April 2019. The company reports all actuarial gains and losses arising in a year directly in the retained profits.

Required:

(i) Determine the actual gain or losses for each of the years ended 31 March: 2020, 2021 and 2022. (6 marks)

(ii) Prepare the income statement expenses for each of the years ended 31 March: 2020, 2021 and 2022. (2 marks)

(iii) Prepare the asset or liability to be reported in the statements of financial position as at 31 March: 2020, 2021 and 2022. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following trial balance was extracted from the books of Parkar Ltd as at 30 September 2022:

	Sh.“000”	**Sh.“000”**
Ordinary shares (each share Sh.20 par value)		180,000
Share premium		12,000
Retained profit (1 October 2021)		15,240
Deferred Tax		16,980
Bank and cash balance	22,640	
Investment at fair value	53,880	
Land	40,200	
Buildings	85,200	
Plant and machinery	433,200	

	Sh."000"	Sh."000"
Accumulated depreciation		
Building		12,780
Plant and machinery		255,420
Revenue		400,000
Cost of sales	131,340	
Inventory (30 September 2022)	12,900	
Distribution costs	13,380	
Administrative expenses	22,680	
Income tax	17,160	
Investment property at fair value (1 October 2021)	40,680	
Finance cost	14,040	
8% Redeemable preference shares		30,000
10% debentures		60,000
Intangible assets	68,400	
Trade receivables and trade payables	37,400	10,680
	993,100	993,100

Additional information:

1. Inventory as at 30 September 2022 included partially damaged and slow moving goods. The cost of these goods was Sh.900,000 and they were eventually sold in October 2022 for Sh.256,800.
2. The fair value of the investment property on 30 September 2022 was Sh.41,580,000.
3. The following details are relevant to the property, plant and equipment:
   - On 30 September 2022, the land and building were revalued to Sh.51 million and Sh.91.2 million respectively. The new values were to be included in the financial statements for the year ended 30 September 2022.
   - Plant and machinery are depreciated on a straight line basis over 10 years.
   - Buildings are depreciated at $2^1/_2$% per annum on straight line basis.
   - Depreciation for the current year has been provided.

4. Information relating to intangible assets was as follows:
   The intangible assets include:

	Cost Sh."000"	Accumulated Amortisation Sh."000"
Development cost on software (it is to be amortised over 5 years)	51,600	30,960
Patent	31,200	-
Research cost	16,560	-

   - The patent was acquired on 1 November 2019. It was determined that the patent had an indefinite useful life when it was acquired. However, on 1 October 2021 due to a new competitor gaining grounds on the company's technology, the patent's fair value was estimated to be Sh.27 million with estimated useful life of 3 years.
   - The research cost was incurred during the year in developing new software which was not successful.

5. Finance costs comprised:

	Sh."000"
Interim dividend paid on ordinary shares	8,880
Dividends paid on redeemable preference shares	2,400
Interest on debentures	6,000
Investment income from tax exempt companies	(3,240)
	14,040

6. The balance on the income tax in the trial balance represents the amount paid for the year. The tax expenses for the year is estimated to be Sh.15,540,000 inclusive of an increase in deferred tax liability of Sh.2,040,000.
7. The directors approved the issue of one bonus share for every 9 shares held at par value.

Required:
Prepare the following:

(i) Comprehensive income statement for year ended 30 September 2022. (6 marks)

(ii) Statement of changes in equity for the year ended 30 September 2022. (4 marks)

(iii) Statement of financial position as at 30 September 2022. (10 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

TUESDAY: 2 August 2022. Afternoon paper. **Time Allowed: 3 hours.**

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

QUESTION ONE

(a) Highlight six steps to developing an effective analysis of financial statements. (6 marks)

(b) Sustainability investing is an approach to investment where environmental, social or governance factors (ESG) in combination with financial considerations, guide the selection and management of investment.

Required:

In relation to the above statement, discuss three reasons why the disclosure of sustainable information has become an important part and influential consideration for investors. (6 marks)

(c) The new owners of EMCO Software Limited changed the firm's pension scheme on 30 September 2021 to include all of its staff. The benefits accrue from the date of their employment, but only vest after two years of additional service from 30 September 2021. The net pension obligation at 30 September 2021 was Sh.78 million which has been updated to include this change. During the year, benefits of Sh.6 million were paid under the scheme and EMCO Limited contributed Sh.10 million to the scheme. These payments had been recorded in the financial statements. The following information relates to the pension scheme:

	Sh.“million”
Net pension obligation at 30 September 2021	78
Net pension obligation at 30 September 2020	59
Service costs for the year	18
Past service cost relating to scheme amendment at 30 September 2021	9
Discount rate at 30 September 2020	5.5%
Discount rate at 30 September 2021	5.9%

EMCO Limited has a profit before tax for the year ended 30 September 2021 of Sh.25 million

Required:

(i) Determine the amount to be reported in other comprehensive income (OCI) after remeasurement of the defined benefit obligation. (5 marks)

(ii) Adjust the profit before tax to account for the remeasurement of the defined benefit obligation. (3 marks)

(Total: 20 marks)

QUESTION TWO

(a) (i) Explain the term “creative accounting”. (2 marks)

(ii) Describe four examples of creative accounting. (4 marks)

(b) The following are summarised financial statements for Babito Ltd. with accounting year ending on 31 March 2021 and 31 March 2022:

Summarised statement of financial position as at 31 March:

	2021		2022	
Assets:	**Sh.“000”**	**Sh.“000”**	**Sh.“000”**	**Sh. “000”**
Non current assets		4,995		12,700
Current assets:				
Inventories	40,145		50,455	
Trade receivables	40,210		43,370	
Bank	12,092	92,447	5,790	99,615
Total assets		97,442		112,315
Equity and liability:				
Sh.0.25 ordinary share	9,920		9,920	
Retained earnings	30,820	40,740	40,080	50,000
Non current liability:				
10% debentures 2015/2016		19,840		19,840
Current liabilities:				
Trade payables	32,604		37,230	
Taxation	4,258	36,862	5,245	42,475
Total equity and liabilities		97,442		112,315

Summarised income statement for the year ended 31 March:

	2021	2022
	Sh.“000”	**Sh.“000”**
Revenues	486,300	583,900
Profit from operations	17,238	20,670
Interest payable	(1,984)	(1,984)
Profit for the year before tax	15,254	18,686
Tax	(5,734)	(7,026)
Profit for the year after tax	9,520	11,660

There was no other comprehensive income in the period

Summarised statement of changes in equity for the year ended 31 March:

	2021	2022
	Sh.“000”	**Sh.“000”**
Retained earnings brought forward	23,540	30,820
Total comprehensive income for the year	9,520	11,660
Dividends	(2,240)	(2,400)
Retained earnings carried forward	30,820	40,080

Required:

For each year, compute two ratios for each of the following user groups, which are of particular significance to them:

(i) Shareholders. (4 marks)

(ii) Creditors. (4 marks)

(iii) Internal management. (4 marks)

(iv) Examine two advantages of ratio analysis. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Grace Mambo has gathered the following research notes for the following three companies that reflect trends during the last three years:

Nkubu Ltd.

Note 1: Operating income has been much lower than operating cash flow (OCF).

Note 2: Accounts payable has increased, while accounts receivable and inventory have substantially decreased.

Note 3: Although OCF was positive, it was just sufficient to cover capital expenditures, dividends and debt repayments.

Tororo Ltd.

Note 4: Operating margins have been relatively constant.

Note 5: Growth rate in revenue has exceeded the growth rate in receivables.

Note 6: OCF was stable and positive, close to its reported net income and just sufficient to cover capital expenditures, dividends and debt repayments.

Kisauni Ltd.

Note 7: OCF has been more volatile than that of other industry participants.

Note 8: OCF has fallen short of covering capital expenditure, dividends and debt repayment.

Required:

Citing relevant reasons, determine the company that would be described as having high quality cash flow. (6 marks)

(b) The comparative statements of financial position as at 31 December 2021 and 31 December 2020 and the income statement for the year 2021 for Bidii Ltd. are provided below:

Bidii Ltd.

Statement of financial position as at 31 December 2021 and 31 December 2020:

	2021	**2020**
	Sh."000"	**Sh."000"**
Cash	24,000	41,000
Accounts receivable	94,000	96,000
Investments revenue receivable	3,000	2,000
Inventory	115,000	110,000
Prepaid insurance	2,000	3,000
Long term investments	77,000	60,000
Land	110,000	80,000
Patent	15,000	16,000
Property, plant and equipment	220,000	240,000
Less accumulated depreciation	(35,000)	(60,000)
	625,000	588,000
Liabilities:		
Accounts payable	23,000	30,000
Salaries payable	2,000	5,000
Interest payable	4,000	2,000
Income tax payable	6,000	8,000
Deferred tax liability	5,000	4,000
Notes payable	15,000	-
Bonds payable	150,000	130,000
Less discount on bonds	(9,000)	(10,000)
Shareholders equity:		
Ordinary shares	210,000	200,000
Paid in capital – excess of par	44,000	40,000
Retained earnings	182,000	179,000
Less treasury bills (at cost)	(7,000)	-
	625,000	588,000

Bidii Ltd.

Income statement for the year ended 31 December 2021

	Sh."000"	**Sh."000"**
Revenues:		
Sales revenue	200,000	
Investment revenue	6,000	
Gain on sale of treasury bills	1,000	207,000
Expenses and losses:		
Cost of goods sold	110,000	
Salaries expense	30,000	
Depreciation expenses	5,000	
Amortisation expenses	1,000	
Insurance expense	3,000	
Interest expense	14,000	
Loss on sale of equipment	10,000	
Income tax expense	7,000	(180,000)
Net income		27,000

Additional information:

1. Investment revenue includes Bidii Ltd.'s Sh.3 million share of the net income of Tobiko Ltd., an equity method investee.
2. Treasury bills were sold during the year 2021 at a gain of Sh.1 million. Bidii Ltd. classifies its investments in Treasury bills as cash equivalents.
3. Equipment that originally cost Sh.60 million and was one half depreciated was rendered unusable. The major components of the equipment were sold for Sh.20 million.
4. Temporary differences between pre-tax accounting income and taxable income caused the deferred tax liability to increase by Sh.1 million.
5. The ordinary shares of Murinduko Ltd. was purchased for Sh.14 million as a long term investment.
6. Land costing Sh.30 million was acquired by paying Sh.15 million in cash and issuing a 13% seven year, Sh.15 million note payable to the seller.
7. New equipment was purchased for Sh.40 million cash.
8. Sh.20 million bonds were issued at face value.
9. On 19 January 2020, Bidii Ltd. issued a 5% stock dividend (1 million shares). The market price of the Sh.10 par value ordinary shares was Sh.14 per share at that time.
10. Cash dividends of Sh.10 million were paid to shareholders.
11. In November 2020, 500,000 ordinary shares were repurchased as treasury stock at a cost of Sh.7 million.

Required:

Statement of cash flows for Bidii Ltd. for the year ended 31 December 2021 using the direct method. (14 marks)

(Total: 20 marks)

QUESTION FOUR

(a) In relation to segment reporting:

(i) Explain what is involved in financial reporting for segment of a business enterprise. (2 marks)

(ii) Evaluate two accounting difficulties inherent in segment reporting. (4 marks)

(b) The statement of comprehensive income for three entities for the year ended 31 March 2022 are presented below:

	BH Ltd. Sh."000"	NJ Ltd. Sh."000"	MK Ltd. Sh."000"
Revenue	3,360	3,240	2,390
Cost of sales	(1,800)	(1,860)	(1,380)
Gross profit	1,560	1,380	1,010
Administrative expenses	(380)	(340)	(250)
Distribution costs	(400)	(300)	(150)
Investment income	80	-	-
Finance costs	(180)	(140)	(110)
Profit before tax	680	600	500
Income tax expense	(200)	(160)	(150)
Profit for the year	480	440	350
Other comprehensive income:			
Revaluation of property, plant and equipment	70	40	30
Gain on investment in NJ Ltd. and MK Ltd.	96	-	-
Tax effect of other comprehensive income	(50)	(16)	(10)
Other comprehensive income for the year net of tax	116	24	20
Total comprehensive income for the year	596	464	370

Additional information:

1. BH Ltd. acquired a 25% investment in NJ Ltd. on 1 September 2013 for Sh.300,000. The investment was classified as available for sale and the gains earned on it have been recorded within other comprehensive income in BH Ltd.'s individual financial statements. The fair value of the 25% investments at 31 March 2021 was Sh.400,000 and at 1 January 2022 was Sh.425,000. BH Ltd. was not able to exercise significant influence over the financial and operating policies of NJ Ltd.

   On 1 January 2022, BH Ltd. acquired an additional 40% of the 1 million Sh.1 equity shares of NJ Ltd. for Sh.680,000. The retained reserves of NJ Ltd. that date were Sh.526,000. The group policy is to value the non-controlling interest at its fair value at the date of acquisition. The non-controlling interest had a fair value of Sh.581,000 at 1 January 2022. NJ Ltd. lost a key customer in February 2022 and BH Ltd.'s directors have decided that goodwill on acquisition is impaired by 10% at 31 March 2022. Impairment losses are charged to group administrative expenses.

The investment in NJ Ltd. continues to be held as an available for sale asset in BH Ltd. individual financial statements and recorded at its fair value of Sh.1,170,000 at 31 March 2022. The total gains recorded to date in respect of NJ Ltd. are Sh.190,000 of which Sh.90,000 occurred in the year and are included in the other comprehensive income of BH Ltd.

2. BH Ltd. acquired 40% of the equity share capital of MK Ltd. for Sh.334,000 on 1 October 2021. The investment was classified as available for sale and the gains earned on it since its acquisition have been recorded within other comprehensive income in the years in BH Ltd.'s individual financial statements. The fair value of this available for sale assets at 31 March 2022 was Sh.370,000. BH Ltd. exercises significant influence over the financial and operating policies of MK Ltd.

   A new competitor has recently entered the market in which MK Ltd. operates and it is likely that this will have an immediate impact on MK Ltd.'s profits in the coming period. As a result, the directors of BH Ltd. have decided that the investment in MK Ltd. should be subject to 10% impairment at 31 March 2021.
3. NJ Ltd. sold goods to BH Ltd. in January 2022 for Sh.200,000. Half of these items remain in BH Ltd.'s inventories at the year end. NJ Ltd. earns a 20% gross margin on all sales.
4. The profits of all the three entities can be assumed to accrue evenly throughout the year. Assume there is no further impact to income tax figures.
5. MK Ltd. paid a dividend of Sh.80,000 to its equity shareholders on 31 March 2022. BH Ltd. included its share of the dividend in investment income.

Required:
Consolidated statement of comprehensive income for BH Ltd. group for the year ended 31 March 2022. (14 marks)
(Total: 20 marks)

QUESTION FIVE

(a) Insta Ltd. has several investments in the securities of other companies. The following information regarding these investments is available as at 31 December 2021:

1. Insta Ltd. holds bonds issued by Kanunga Ltd. The bonds have an amortised cost of Sh.320,000 and their fair value at 31 December 2021 is Sh.400,000. Insta Ltd. intends to hold the bonds until they mature on 31 December 2029.
2. Insta Ltd. has invested idle cash in the equity securities of several publicly traded companies. Insta Ltd. intends to sell these securities during the first quarter of 2022, when it needs the cash to acquire seasonal inventory. Those equity securities have a cost basis of Sh.800,000 and a fair value of Sh.920,000 at 31 December 2021.
3. Insta Ltd. has a significant ownership in one of the companies that supplies it with various components. Insta Ltd. owns 6% of the ordinary shares of the supplier and does not have any representation on the supplier's board of directors, does not exchange any personnel with the supplier and does not consult with the supplier or any of the supplier's operating, financial or strategic decisions. The cost basis of the investment in the supplier is Sh.1,200,000 and the fair value of the investment at 31 December 2021, is Sh.1,550,000. Insta Ltd. does not intend to sell the investment in the foreseeable future. The supplier reported net income of Sh.80,000 for the year ended 31 December 2021 and paid no dividends.
4. Insta Ltd. owns some ordinary shares of Solomon Ltd. The cost basis of the investment in Solomon Ltd. is Sh.200,000 and the fair value at 31 December 2021 is Sh.50,000. Insta Ltd. believes the decline in the value of its investment in Solomon Ltd. is permanent and therefore impaired, but Insta Ltd. does not intend to sell its investment in Solomon Ltd. in the foreseeable future.
5. Insta Ltd. purchased 25% of the ordinary shares of Thogoto Ltd. for Sh.900,000. Insta Ltd. has significant influence over the operating activities of Thogoto Ltd. During the year 2021, Thogoto Ltd. reported net income of Sh.300,000 and paid a dividend of Sh.100,000.

Required:

(i) Explain the different rationales for the different accounting and reporting rules for different types of investments in the securities of other companies. (4 marks)

(ii) Determine the total effect on Insta Ltd.'s 2021 net income investment in other companies. (4 marks)

(b) Briston Ltd. has just prepared its draft accounts for the year ended 31 December 2021. The external auditor has reviewed these accounts and has advised that these accounts will not be authorised for issue for another three weeks until the following issues are addressed and resolved:

1. In January 2022, a building with a carrying value of Sh.250 million burnt down. It was not insured.
2. In February 2022, inventories with a year-end cost of Sh.79 million were sold for Sh.65 million.

3. In March 2022, a major customer went bankrupt owing Briston Ltd. Sh.235 million. The amount receivable was made up as follows:

Date of invoice:	Sh.
December 2021	64,000
January 2022	123,000
February 2022	48,000
	235,000

4. In May 2021, the directors declared a final dividend of Sh.78 million in respect of year 2020.

The draft statement of financial position of Briston Ltd. was as follows:

	Sh."million"	Sh."million"
Asset:		
Non-current assets		1,126
Current assets:		
Inventory	238	
Trade receivables	436	
Bank	400	1,074
		2,200
Equity and liabilities:		
Capital and reserves	1,000	
Non-current liabilities	500	
Current liabilities	700	2,200

Required:

(i) Explain how each of the above four events after the reporting period will be accounted for. (8 marks)

(ii) Redraft the statement of financial position to incorporate all of the adjusting events after the reporting period according to, International Accounting Standard, IAS 10-Events after reporting date. (4 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

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

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

QUESTION ONE

(a) Management commentary is a key source of information for financial statements analysis. It is one of the most useful sections of the annual report.

Required:

In light of the above statement, enumerate four issues that management discusses in the management discussions and analysis (MDAs). (4 marks)

(b) In the context of International Financial Reporting Standard (IFRS) 5 "Non-current assets held for sale and discontinued operations", explain the meaning of the term "discontinued operations". (2 marks)

(c) International Financial Reporting Standard (IFRS) 16 "Leases" sets out the principles for the recognition, measurement, presentation and disclosures of leases.

Required:

Explain the optional exemption from the full requirements of the standard in accounting for leases in the financial statements of the lessee. (4 marks)

(d) Twiga Ltd. owns 70% of the ordinary share capital of Ndovu Ltd. The total group equity as at 31 December 2020 was Sh.4,000,000, which included Sh.650,000 attributable to non-controlling interest.

Twiga Ltd. purchased a further 20% of the ordinary share capital of Ndovu Ltd. on 1 October 2021 for Sh.540,000.

During the year to 31 December 2021, Twiga Ltd. issued 2 million, Sh. 1 ordinary shares, fully paid at Sh.1.30 per share.

Dividends were paid by both group entities in April 2021. The dividends paid by Twiga Ltd. and Ndovu Ltd. were Sh.200,000 and Sh.100,000 respectively.

Total comprehensive income for the year ended 31 December 2021 for Twiga Ltd. was Sh.900,000 and for Ndovu Ltd. was Sh.600,000.

Income is assumed to accrue evenly throughout the year.

Required:

(i) Explain the impact of the additional 20% purchase of Ndovu Ltd.'s ordinary share capital by Twiga Ltd. on the equity of the Twiga Ltd. group. (2 marks)

(ii) Prepare the consolidated statement of changes in equity for the year ended 31 December 2021 for the Twiga Ltd. group showing the total equity attributable to the parent and to the non-controlling interest. (8 marks)

(Total: 20 marks)

QUESTION TWO

(a) In recent years, many financial analysts have commented on a growing disillusionment with the usefulness and reliability of the information contained in some companies' income statements and statements of financial position.

In reference to the above statement, discuss two reasons as to why a company's statement of cash flows may be more reliable than its income statement. (4 marks)

(b) Solomon Mbogo, a financial analyst at Liman Consultants, is tasked to carry out cross-sectional analysis of financial statements across firms within the same industry.
The following financial statements for the year ended 30 September 2021 were extracted from industry competitors, Movid Limited and Rogid Limited.

Income statements for the year ended 30 September 2021:

	Movid Ltd. Sh. "000"	Rogid Ltd. Sh. "000"
Revenue	40,500	20,520
Cost of sales	(16,200)	(6,480)
Gross profit	24,300	14,040
Administrative expenses	(7,560)	(4,320)
Distribution expenses	(3,700)	(1,870)
Research expenses	(2,430)	(1,240)
Operating profit	10,610	6,610
Finance costs	(1,080)	(540)
Profit before tax	9,530	6,070
Income tax expense	(5,400)	(2,730)
Profit for the year	4,130	3,340

Statements of financial position as at 30 September 2021:

	Movid Ltd. Sh. "000"	Rogid Ltd. Sh. "000"
Non-current assets:		
Property, plant and equipment	34,600	25,920
Intangible assets	11,200	13,160
Investments at fair value	10,500	-
	56,300	39,080
Current assets:		
Inventory	26,800	24,500
Trade and other receivables	33,750	23,250
Cash and cash equivalents	4,100	-
	64,650	47,750
Total assets	120,950	86,830
Equity and liabilities:		
Ordinary shares of Sh.10 each	32,400	25,900
Revaluation reserve	2,950	1,860
Retained profit	8,100	7,560
Total equity	43,450	35,320
Non-current liabilities:		
Long-term borrowings	15,800	10,200
Deferred tax	16,700	9,800
Current liabilities:		
Trade and other payables	29,250	16,250
Current tax	15,750	12,500
Bank overdraft	-	2,760
Total equity and liabilities	120,950	86,830

Required:

(i) Common size income statements for the two entities for the year ended 30 September 2021. (6 marks)

(ii) Common size statements of financial position as at 30 September 2021. (6 marks)

(iii) Analyse the relative financial performance and financial position of the two firms. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) The following financial information was extracted from records of Maxson limited:

	Sh. "million"
Revenue	48,820
Operating profit	11,960
Finance costs	420
Income tax expense	3,200
Total asset turnover	1.17 times
Financial leverage	0.97
Return on assets	8.8%

Required:

The entity's return on equity (ROE) using a five-step variant of DuPont analysis. (4 marks)

(b) Betax Ltd. is a subsidiary of Alphax Ltd. The summarised draft financial statements of both companies are provided as follows:

Income statements for the year ended 31 March 2022:

	Alphax Ltd.	Betax Ltd.
	Sh. "000"	Sh. "000"
Sales revenue	120,000	48,000
Cost of sales	(84,000)	(40,000)
Gross profit	36,000	8,000
Operating expenses	(12,000)	(400)
Loan interest received/paid	150	(400)
Profit before tax	24,150	7,200
Tax	(6,000)	(1,200)
Profit for the year	18,150	6,000

Statements of financial position as at 31 March 2022:

	Alphax Ltd.	Betax Ltd.
Assets:	Sh. "000"	Sh. "000"
Tangible non-current assets	38,640	16,000
Investment	22,560	-
	61,200	16,000
Current assets:	30,000	16,000
Total assets	91,200	32,000
Equity and liabilities:		
Equity ordinary shares of Sh.1 each	20,000	4,000
Retained earnings	51,200	16,800
	71,200	20,800
Non-current liabilities:		
10% loan notes	-	4,000
Current liabilities	20,000	7,200
Total equity and liabilities	91,200	32,000

Additional information:

1. On 1 July 2021, Alphax Ltd. acquired 80% of the ordinary share capital of Betax Ltd. at a cost of Sh.20,560,000.

   On the same date, it also acquired 50% of Betax Ltd.'s 10% loan notes at par.
2. The fair values of Betax Ltd.'s assets were equal to their book values with the exception of its plant, which had a fair value of Sh.6.4 million in excess of its book value at the date of acquisition. The remaining life of all the Betax Ltd. plant at the date of acquisition was four years and this has not changed as a result of the acquisition.
3. Depreciation of plant is on a straight line basis and charged to the cost of sales. Betax Ltd. has not adjusted the value of its plant to match its fair value.
4. In the post acquisition period, Alphax Ltd. sold goods to Betax Ltd. at a price of Sh.24 million. These goods had cost Alphax Ltd. Sh.18 million. During the year, Betax Ltd. had sold Sh.20 million (at cost to Betax Ltd.) of these good for Sh.30 million.
5. Alphax Ltd. bears almost all of the administration costs incurred on behalf of the group (invoicing, credit control among others). It does not charge Betax Ltd. for this service as to do so would not have a material effect on the group profit.
6. Revenues and profits should be deemed to accrue evenly throughout the year.
7. The current accounts of the two companies were reconciled at the year end with Betax Ltd. owing Alphax Ltd. Sh.1.5 million.
8. The goodwill was reviewed for impairment at the end of the reporting period and had suffered an impairment loss of Sh.600,000 which is to be treated as an operating expense.
9. Alphax Ltd.'s opening retained earnings were Sh.33,050,000 and Betax Ltd.'s were Sh.10,800,000.
10. No dividends were paid or declared by either entity during the year.
11. It is the group policy to value the non-controlling interest at acquisition at fair value. The directors valued the non-controlling interest at Sh.5 million at the date of acquisition.

Required:

(i) Consolidated statement of comprehensive income for the year ended 31 March 2022 for Aphax Ltd. (6 marks)

(ii) Consolidated statement of financial position as at 31 March 2022 for Alphax Limited. (8 marks)

(iii) Explain two reasons why it is necessary to eliminate unrealised profits when preparing group financial statements. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Financial statements analysis can be a very useful tool for understanding a firm's performance and financial condition. However, there are certain challenges and issues encountered in such analysis which call for care, discretion and judgement.
In relation to the above statement, discuss six inherent challenges with inputs that will influence the quality of the output from the financial analysis. (6 marks)

(b) Outline three circumstances under which International Financial Reporting Standard (IFRS) 9 "Financial Instruments" permits hedge accounting. (3 marks)

(c) Flame Tree Ltd. achieved revenues of Sh.48,000,000 in the year that has just ended and expect a revenue growth rate of 10% in the next year. Cost of sales in the year that has just ended was Sh.32,640,000 and other expenses were Sh.4,320,000.

The financial statement of flame tree Ltd. for the year ended 31 December 2021 are as follows:

Statement of financial position as at 31 December 2021:

	Sh."000"	Sh."000"
Non-current assets		66,000
Current assets:		
Inventory	7,200	
Trade receivables	6,600	13,800
Total assets.		79,800
Equity finance:		
Ordinary shares	15,000	
Reserves	22,500	37,500
Long-term bank loan		30,000
	67,500	
Current liabilities:		
Trade payables	5,700	
Overdraft	6,600	12,300
Total capital and liabilities		79,800

Additional information:

1. The long-term bank loan has a fixed annual interest rate of 8%.
2. The company pays corporation tax at an annual rate of 30% per annum.
3. The following accounting ratios have been forecast for the year 2022.

Gross profit margin	30%
Operating profit margin	20%
Dividend payment ratio	50%
Inventory turnover period	110 days
Trade receivables period	65 days
Trade payables period	75 days

4. The overdraft interest in the year 2022 is forecast to be Sh.420,000.
5. No change is expected in the level of non-current assets and depreciation should be ignored. Assume 365 days in a year.

Required:

Prepare the following forecast financial statements for Flame Tree Ltd. using the information provided:

(i) A forecast statement of profit or loss for the year ending 31 December 2022. (5 marks)

(ii) A forecast statement of financial position as at 31 December 2022. (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Describe three accounting warning signs that could indicate possible deviations from high quality financial reports. (6 marks)

(b) Discuss under what circumstances, if any, revenue might be recognised at the following stages of a sale:

(i) Goods are acquired by the business which it confidently expects to resell very quickly. (1 mark)

(ii) A customer places a firm order for goods. (1 mark)

(iii) Goods are delivered to the customer. (1 mark)

(iv) The customer is invoiced for goods. (1 mark)

(c) NPK Limited ordinary shares are actively traded on the securities exchange. For the year ended 31 December 2021, the firm net income was Sh.183,000. Its income tax rate is 30%.

The average market price of its share during the year 2021 was Sh.24.

Additional information:

1. There were 75,000 ordinary shares outstanding at 1 January 2021. An additional 150,000 shares were issued on 1 July 2021.
2. A two for one share split was declared and distributed on 1 October 2021.
3. On 1 January 2020, NPK Limited issued at par Sh.300,000, 8% bonds that mature on 1 January 2028. Each Sh.1,00 bond is convertible into 55 ordinary shares. The effective interest rate is 8%.
4. There are 15,000 outstanding cumulative preference shares that are each entitled to an annual dividend of Sh.0.30. Dividends were not declared or paid during the year 2021. Each preferred share is convertible into two ordinary shares.
5. NPK Limited previously granted its employees options to acquire 5,000 ordinary shares at an exercise price of Sh.25 each. These options expire on 30 June 2026.
6. NPK Limited previously granted its executives options to acquire 1,800 ordinary shares at an exercise price of Sh.20 each. These options expire on 31 August 2027.

Required:

Calculate the following for the year ended 31 December 2021:

(i) Basic earnings per share (EPS). (4 marks)

(ii) Diluted earnings per share (EPS). (6 marks)

(Total: 20 marks)

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CIFA INTERMEDIATE LEVEL

FINANCIAL STATEMENTS ANALYSIS

WEDNESDAY: 15 December 2021 **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Evaluate four objectives of financial statements. (8 marks)

(b) Mwangaza Ltd. manufactures solar panels for home use. Over the past few years, the company's sales have greatly increased. Such dramatic growth has significant implications for cash flows.

Provided below are the cash flows for the year ended 30 September 2020 and 30 September 2021.

Mwangaza Ltd.
Cash flow statements for the year ended 30 September:

	2021 **Sh.**	**2020** **Sh.**
Cash flow from operating activities:		
Net income	17,523	838,955
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	(69,524)	(146,590)
Depreciation and amortisation	316,416	181,348
Changes in assets and liabilities:		
Accounts receivable	(38,267)	(25,947)
Inventories	(1,599,014)	(1,289,293)
Prepaid and other current assets	(444,794)	(113,205)
Deposits and other assets	(24,240)	(83,044)
Accounts payable	2,017,059	(284,567)
Accrued expenses	61,321	170,755
Accrued interest payable on debentures	-	(58,219)
Other Liabilities	-	(8,960)
Income taxes payables	-	117,810
Net cash provided by (used for) operating activities	236,480	(700,957)
Net cash used for investing activities	(2,102,892)	(4,422,953)
Net cash (used for) provided by financing activities	(315,353)	9,685,435
Net change in cash and cash equivalents	(2,181,765)	4,561,525

Additional information:

1. The liabilities and net sales were as follows:

	September 2021	**September 2020**
Current liabilities	4,055,465	1,995,600
Total liabilities	4,620,085	2,184,386
Net sales	20,560,566	17,025,856

2. Included in net cash used for investing activities is machinery purchase of Sh.50,000 for the year ended 30 September 2020 and Sh.60,000 for the year ended 30 September 2021.
3. No dividends were paid in the year ended 30 September 2020, but Sh.20,000 was paid in the year ended 30 September 2021.
4. An analyst observes that net income in the year ended 30 September 2021 was only Sh.17,253 compared to the previous year ended 30 September 2020 of Sh.838,955, but net cash flow from operating activities was Sh.236,480 in the current year ended 30 September 2021 and a negative Sh.700,957 in the year ended 30 September 2020.

Required:

(i) Discuss two causes of the situation that the analyst observed. (4 marks)

(ii) Analyse Mwangaza Ltd.'s liquidity, solvency and profitability for the year ended 30 September 2021 using cash flow based ratios. (6 marks)

(iii) Calculate the firm's free cash flow. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) On 17 January 2020, Daudi Ltd. invested Sh.11 million in Barua's debt securities, with a 5% stated coupon on par value and interest payable each 31 December. The par value of the securities is Sh.10 million, and the market interest rate in effect when the bonds were purchased was 4%. Daudi Ltd. designates the investment as held to maturity. As of 31 December 2020, the fair value of Barua's debt securities was Sh.12 million.

Required:

The amortised cost of Barua's debt securities in the financial statements of Daudi Ltd. as at 31 December 2020. (4 marks)

(b) Discuss four factors that might stimulate the use of creative accounting techniques in an organisation.(8 marks)

(c) Roxy Ltd. wants to raise Sh.40 million in capital by borrowing against its financial receivables. Roxy Ltd. wants to create a special purpose entity (SPE), invest Sh.10 million in the SPE, have the SPE borrow Sh.40 million and then use the funds to purchase Sh.50 million of receivables from Roxy Ltd. Roxy Ltd. meets the definition of control and plans to consolidate the SPE. Roxy Ltd.'s summarised financial statement is presented below:

	Sh."million"		Sh."million"
Cash	20	Current liabilities	25
Accounts receivable	50	Non-current liabilities	30
Other assets	30	Shareholders' equity	45
Total assets	100	Total liabilities and equity	100

Roxy Ltd. plans to borrow against its financial receivables.

Required:

Calculate the following ratios, before and after consolidation of the SPE:

(i) The current ratio. (4 marks)

(ii) The debt equity ratio. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain the following qualitative characteristics of financial reports:

(i) Reliance. (2 marks)

(ii) Faithful representation. (2 marks)

(b) LOP Limited operates in the construction industry and prepares its financial statements in accordance with the International Financial Reporting Standards (IFRS). It is listed on its local exchange, LOP Limited is considering expanding its overseas operations by acquiring a new subsidiary. Two geographical areas have been targeted, Frontland and Sideland. Entity A operates in Frontland and entity B operates in Sideland. Both entities are listed on their local exchange.

The financial highlights for entity A, entity B and LOP Limited are provided below for the last trading period:

	Entity A	Entity B	LOP Limited
Revenue	Sh.160 million	Sh.300 million	Sh.500 million
Gross profit margin (%)	26	17	28
Net profit (%)	9	11	16
Gearing (%)	65	30	38
Average rate of interest available in the respective markets (%)	5	9	8
Price earning (P/E) ratio	11.6	15.9	16.3

Required:

(i) Analyse the information provided by the key financial indicators above and explain the impact that each entity would have on the financial indicators of LOP Limited. (8 marks)

(ii) Explain two limitations of using ratio analysis on a potential takeover target. (2 marks)

(c) A financial analyst is forecasting earnings per share (EPS) for a company. He prepares the following common sized data from its recent annual report and estimates sales for the year 2022.

	2022 Forecast	2021 Actual	2020 Actual
Sales (Sh. "millions")	2,250	2,150	1,990
Sales as a % of sales		100%	100%
Cost of goods sold		45%	45%
Operating expenses		40%	40%
Interest expense		3.72%	4.02%
Restructuring expense		-	7.20%
Pretax margin		11.28%	3.78%
Taxes (30%)		3.38%	1.13%
Net income		7.90%	2.65%

The capital structure of the company has not changed and the company has no short-term interest bearing debt outstanding.

Required:

The net projected income for the year 2022. (6 marks)

(Total: 20 marks)

QUESTION FOUR

(a) The statements of financial position for ABC Ltd. and XYZ Ltd. as at 31 December 2020 are provided below:

	ABC Ltd. Sh."000"	XYZ Ltd. Sh."000"
Asset		
Non-current assets:		
Property, plant and equipment	24,000	8,000
Available for sale investment	8,000	-
	32,000	8,000
Current assets:		
Inventories	4,400	1,600
Accounts receivable	6,800	1,800
Cash and cash equivalents	1,600	600
	12,800	4,000
Total assets	44,800	12,000
Equity and liabilities:		
Equity:		
Share capital (Sh.1 ordinary shares)	20,000	2,000
Retained earnings	15,000	8,000
Other reserves	400	-
	35,400	10,000
Non-current liabilities:		
Long term loan	5,400	-
Current liabilities	4,000	2,000
Total liabilities	9,400	2,000
Total equity and liabilities	44,800	12,000

Additional information:

1. ABC Ltd. acquired a 75% investment in XYZ Ltd. on 1 May 2020 for Sh.7,600,000. The investment has been classified as available for sale in the books of ABC Ltd. The gain on its subsequent measurement as at 31 December 2020 has been recorded within other reserves in ABC's individual financial statements. At the date of acquisition, XYZ Ltd. had retained earnings of Sh.6,400,000.
2. It is the group policy to value non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interest at 1 May 2020 was Sh.3,200,000.

3. As at 1 May 2020, the fair value of the net assets acquired was the same as the book value with the following exceptions:
   - The fair value of property, plant and equipment was Sh.3,600,000 higher than the book value. These assets were assessed to have an estimated useful life of 36 years from the date of acquisition.
   - A full year's depreciation is charged in the year of acquisition and none in the year of sale.
   - The fair value of inventories was estimated to be Sh.400,000 higher than the book value. All of these inventories were sold by 31 December 2020.
4. On acquisition, ABC Ltd. identified an intangible asset that XYZ Ltd. developed internally which met the recognition criteria of International Accounting Standards (IAS) 38 "Intangible Assets". This intangible asset is expected to generate economic benefit from the date of acquisition until 31 December 2021. This asset was valued at Sh.300,000 at the date of acquisition.
5. A contingent liability, which had a fair value of Sh.420,000 at the date of acquisition, had a fair value of Sh.168,000 at 31 December 2020.
6. An impairment review was conducted at 31 December 2020 and it was decided that the goodwill on the acquisition of XYZ Ltd. was impaired by 20%.
7. During the year ended 31 December 2020, ABC Ltd. sold goods to XYZ Ltd. for Sh.600,000. Half of these goods remained in inventories at 31 December 2020, ABC Ltd. makes 20% margin on all sales.
8. No dividends were paid by either entity in the year ended 31 December 2020.
9. During the year ended 31 December 2020, ABC Ltd. disposed of equipment with a net book value of Sh.2,000,000.

Required:
The consolidated statement of financial position as at 31 December 2020 for ABC group. (14 marks)

(b) Summarise six items that could be included in the notes to financial statements. (6 marks)
(Total: 20 marks)

QUESTION FIVE

(a) The authorised share capital of Zimtex Limited is made up of 10 million ordinary shares with a paid up share capital of Sh.6,750,000 represented by 6 million ordinary shares of Sh.1.125 each.

Additional information:
1. Earnings after tax for the year ended 30 June 2021 were Sh.5,400,000. The company has no debt capital.
2. The price earnings (P/E) ratio of the company is 22.5.
3. The company plans to make a large investment at a cost of Sh.15,750,000. This is to be raised through a rights issue with a price of Sh.12 per share.

Required:
(i) The current market price per share. (2 marks)

(ii) The theoretical ex-right price per share. (3 marks)

(b) On 28 February 2020, Red Group purchased a machine for Sh.1,500,000 for the purpose of leasing it. The machine is expected to have a 10 year life, no residual value and will be depreciated on a straight-line basis. The machine was leased to Blue Ltd. on 1 March 2020 for a four year period at a monthly rental of Sh.19,500. There is no provision for the renewal of the lease or purchase of the machine by the lessee at the expiration of the lease term. Red Group paid Sh.30,000 commission associated with negotiating the lease in February 2020.

Required:
(i) The expense that Blue Ltd. should record in its books as a result of the lease agreement for the year ended 31 December 2020. (1 marks)

(ii) The profit or loss before income taxes that Red Group should record in its books as result of the lease agreement for the year ended 31 December 2020. (3 marks)

(c) Pitkam Limited operates a defined benefit pension plan for its employees and complies with the requirements of International Accounting Standard (IAS 19) "Employee Benefits". The following is an extract of the financial statement for the year ended 31 December 2020

	Sh."million"
Components of net periodic benefit cost:	
Service cost	96
Interest cost	1,557
Expected return plan assets	(1,864)
Recognised past service cost	169
Recognised net actuarial loss	95
Net periodic cost	(43)

	Sh."million"
Change in benefit obligation:	
Benefit obligations: 1 January 2020	28,416
Service cost	96
Interest cost	1,557
Actuarial (gain) losses	(306)
Past service costs	132
Foreign exchange impact	(42)
Benefits paid	(1,322)
Benefit obligations: 31 December 2020	28,531
Change in plan assets:	
Fair value of plan assets: 1 January 2020	23,432
Expected return plan assets	1,874
Actuarial loss	(572)
Employer contributions	693
Benefits paid	(1,322)
Fair value of plan assets as at 31 December 2020	24,105
Funded status:	(4,426)
Unrecognised past service cost	185
Unrecognised actuarial gain	(318)
Net asset/liability in the statement of financial position	(4,559)

The corporation tax rate is 30% per annum.

Required:

(i) The economic pension expense for Pitkam Ltd.'s defined plan for the year ended 31 December 2020. (5 marks)

(ii) Adjust the reported net income to reflect the company's underlying economic benefit expense. (3 marks)

(iii) Adjust Pitkam Ltd.'s 2020 statement of financial position to reflect the funded status of the company's defined benefit pension plan. (3 marks)

(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 24 May 2018. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Distinguish between "top-down approach" from "bottom-up approach" techniques of analysing financial statements by outlining the salient steps followed in each approach. (6 marks)

(b) Neptune Holdings is an entity that operates in the wholesale and retail clothing market sectors across several countries. The firm prepares its financial statements in accordance with the requirements of International Financial Reporting Standards (IFRSs). The directors are considering listing Neptune Holdings on a local securities exchange within the next twelve months. One of the directors has raised concerns about the costs associated with being a listed entity, in particular the additional expense of producing operating segment information.

Required:

(i) Explain how the requirements of IFRS 8 "Operating Segments" assist entities in minimising the cost of producing the operating segment disclosures required by the standard. (2 marks)

(ii) Discuss three benefits that could accrue to the investors from reviewing the operating segment disclosures of Neptune Holdings when making investment decisions. (6 marks)

(iii) Describe two potential limitations that could be faced by investors using operating segment information when making investment decisions. (2 marks)

(c) A motor vehicle manufacturing company commenced operations on 1 January 2017. The following information relates to the company for the financial year ended 31 December 2017:

1. Research and development costs related to software development for internal purposes amounted to Sh.750,000.
2. Start-up costs amounted to Sh.1,200,000.
3. Direct response advertising costs totalled to Sh.225,000.
4. Research and development related to developing a new car model amounted to Sh.500,000.
5. Testing of the prototype model is scheduled for June 2018.
6. Start-up costs have an estimated period of benefits of two years, advertising three years while research and development is estimated at five years.

Required:

Calculate the amount that should be expensed in the company's financial statements for the year ended 31 December 2017. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) The following financial statements were extracted from the books of Melinda Limited:

Statement of comprehensive income for the year ended 31 March 2018

	Sh."million"
Revenue	5,740
Cost of sales	(4,840)
Gross profit	900
Other income	60
Distribution cost	(120)
Administrative expenses	(350)
Finance cost	(50)
Profit before tax	440
Income tax expense	(160)
Profit for the year	280

Other comprehensive income:

Gain on property revaluation	100
Total comprehensive income	380

Statements of financial position as at 31 March:

	2018		2017	
Non-current assets:	**Sh. "million"**	**Sh. "million"**	**Sh. "million"**	**Sh. "million"**
Property, plant and equipment		2,880		1,860
Investment property		420		400
		3,300		2,260
Current assets:				
Inventory	1,210		810	
Accounts receivable	480		540	
Deferred tax asset	Nil		50	
Bank	10	1,700	Nil	1,400
		5,000		3,660
Equity and liabilities:				
Ordinary share capital		1,000		600
Share premium		600		Nil
Revaluation reserves		150		50
Retained earnings		1,440		1,310
		3,190		1,960
Non-current liabilities:				
6% Debentures	Nil		400	
Deferred tax	50	50	30	430
Current liabilities:				
Accounts payable	1,410		1,050	
Bank overdraft	Nil		120	
Warranty provision	200		100	
Current tax payable	150	1,760	Nil	1,270
		5,000		3,660

Additional information:

1. An item of plant with a carrying value of Sh.240 million was sold at a loss of Sh.90 million during the year. Depreciation of Sh.280 million was charged to cost of sales for property, plant and equipment in the year ended 31 March 2018.
   The company uses the fair value model as per International Accounting Standard (IAS) 40: Investment Property.
   There was no acquisition or disposal of investment property during the year.
2. The 6% debentures were redeemed early incurring a penalty payment of Sh.20 million which has been charged as an administrative expense in the income statement.
3. Other incomes comprise:
   - Investment income of Sh.40 million.
   - Revaluation gain of investment property of Sh.20 million.
4. Melinda Limited gives a 12 month warranty on some of the products it sells. The amount shown in current liabilities as warranty provision are an accurate assessment based on past experience of the amount of claims likely to be made in respect of warranties outstanding at each year end. Warranty costs are included in cost of sales.

Required:

(a) A statement of cash flows for the year ended 31 March 2018 in accordance with the requirements of the International Accounting Standard (IAS) 7, Statement of Cash Flows. (14 marks)

(b) Comment on the cash flow management of Melinda Limited as revealed by the statement of cash flows in (a) above and the information provided by the above financial statements. (6 marks)

(Total: 20 marks)

QUESTION THREE

(a) Pauline Nangila and Johnson Mugecha are discussing the recent fraud that occurred at AKIP Limited. The fraud involved the improper reporting of revenue to ensure that the company would have income in excess of Sh.1 billion.

Required:

(i) Explain the term "fraudulent financial reporting". (2 marks)

(ii) Evaluate five ways in which fraudulent financial reporting differs from an embezzlement of company's funds. (5 marks)

(b) (i) Examine two reasons why the components of income tax expense should be disclosed and a reconciliation between the effective tax rate and the statutory tax rate be provided. (2 marks)

(ii) Baobab Cement Limited reported a pre-tax income of Sh.70 million for the year 2017. The following items caused taxable income to be different from pre-tax financial income reported:

1. Depreciation on the tax return was greater than depreciation on the income statement by Sh.16 million.
2. Rent collected on the tax return was greater than rent recognised on the income statement by Sh.22 million.
3. Fines for pollution appear as an expense of Sh.11 million on the income statement.

Baobab Cement Limited's tax rate is 30% for all years and the company expects to report taxable income in all future years. There are no deferred taxes at the beginning of the year 2017.

Required:
Compute the effective income tax rate for the year 2017. (6 marks)

(c) Shadrack Magu, a financial analyst at Beta Capital has gathered the following information about ABC Limited for the year ended 31 December 2017:

1. Net income for the year was Sh.130 million.
2. Outstanding number of ordinary shares for the entire year was 3 million.
3. The company had 1.2 million, 9%, Sh.100 par value preference shares for the entire year with each preferred share being convertible into 5 ordinary shares.
4. The corporate tax rate is 30%.

Required:
(i) Basic earnings per share (EPS). (2 marks)

(ii) Diluted earnings per share (EPS). (3 marks)
(Total: 20 marks)

QUESTION FOUR
Western Corporation was formed 5 years ago through a public subscription of ordinary shares. Douglas Wekesa who owns 15% of the ordinary shares is the current chairman of Western Corporation. The company has been successful, but is currently experiencing a shortage of funds. On 10 June 2017, Wekesa approached Salama Bank requesting for a 24-month extension on two Sh. 35 million notes, which were due on 30 June 2017 and 30 September 2017. Another note of Sh.6 million was due on 31 March 2018, but he expects no difficulty in paying this note on its due date. Wekesa explained that Western Corporation's cash flow problems were due primarily to the company's desire to finance a Sh.300 million plant expansion over the next two financial years through internally generated funds.

The commercial loan officer of Salama Bank obtained the following financial reports of the company for the last two financial years:

Western Corporation
Statement of financial position as at 31 March:

Assets:	**2017**	**2016**
	Sh."000"	**Sh."000"**
Cash	18,200	12,500
Notes receivable	148,000	132,000
Accounts receivable (net)	131,800	125,500
Inventories (at cost)	105,000	50,000
Plant and equipment	1,449,000	1,420,500
Total assets	1,852,000	1,740,500
Liabilities and stockholders' equity:		
Accounts payable	79,000	91,000
Notes payable	76,000	61,500
Accrued liabilities	9,000	6,000
Ordinary shares (130 million shares, Sh.10 par)	1,300,000	1,300,000
Retained earnings	388,000	282,000
	1,852,000	1,740,500

Western Corporation
Income statement
For the financial year ended 31 March

	2017	2016
	Sh."000"	Sh."000"
Sales revenue	3,000,000	2,700,000
Cost of goods sold	(1,530,000)	(1,425,000)
Gross profit margin	1,470,000	1,275,000
Operating expenses	(860,000)	(780,000)
Income before income taxes	610,000	495,000
Income taxes	(244,000)	(198,000)
Net income	366,000	297,000

Additional information:

1. Cash dividends were paid at the rate of Sh.1 per share in the financial year 2016 and Sh.2 per share in the financial year 2017.
2. Depreciation charges on the plant and equipment of Sh.100 million and Sh.102.5 million for the financial years ended 31 March 2016 and 31 March 2017 respectively are included in the cost of goods sold.

Required:

(a) Compute the following items for Western Corporation:

(i) Current ratio for financial year 2016 and 2017. (2 marks)

(ii) Acid-test (quick) ratio for the financial year 2016 and 2017. (2 marks)

(iii) Inventory turnover for financial year 2017. (2 marks)

(iv) Return on asset (ROA) for financial year 2016 and 2017 (Assume total assets were Sh.1,688,500,000 as at 31 March 2015). (2 marks)

(v) Percentage change in sales, cost of goods sold, gross profit margin and net income after taxes from financial year 2016 to 2017. (4 marks)

(b) Propose two financial reports and or financial analysis that might be helpful to the commercial loan officer of Salama Bank in evaluating Wekesa's request for a time extension on Western Corporation's notes. (2 marks)

(c) Assume that the percentage change experienced in the financial year 2017 as compared with financial year 2016 for sales and cost of goods sold will be repeated in each of the next 2 years.

Determine whether Western Corporation's desire to finance plant expansion from internally generated funds is realistic. (5 marks)

(d) Determine whether Salama Bank should grant the extension on Western Corporation's notes considering Wekesa's statement about financing the plant expansion through internally generated funds. (1 mark)

(Total: 20 marks)

QUESTION FIVE

(a) Complex Machineries Limited leased a new model of a machine under the following terms:

1. Four year lease with annual end of year payments of Sh.10,000.
2. At the end of the lease, the lessor regains possession, and the asset is expected to be sold at scrap value.
3. The discount rate on the lease is 6%.
4. The company's incremental borrowing rate is 7%.
5. The company depreciates all its assets on a straight-line basis.
6. Useful life of the machine is 5 years.

Required:

Illustrate how the above lease would be reported in the company's statement of financial position and income statement for each of the next four years. (4 marks)

(b) In relation to the International Financial Reporting Standard (IFRS) 5, "Non-current Assets Held for Sale and Discontinued Operations":

(i) Highlight three conditions that must be met for an asset to be classified as held for sale. (3 marks)

(ii) Allied group operates hotel chain within East Africa. After a period of declining profitability, the directors made the following decisions during the year ended 30 April 2018:

1. To dispose of all of its hotels in Rwanda.
2. To refurbish all of its hotels in Kenya in order to target the business clients market. The previous target market in Kenya had been aimed at the holiday and tourism market.

Required:
Treating the two decisions separately, explain whether they meet the criteria for being classified as discontinued operations in the financial statements for the year ended 30 April 2018. (3 marks)

(c) The following are the extracts from the financial statements of Zoo Limited and Niqe Limited for the year ended 31 December 2017:

Summarised income statement and statement of other comprehensive income for the year ended 31 December 2017:

	Zoo Limited Sh."million"	**Niqe Limited Sh."million"**
Profit from operations	290	140
Finance costs	(45)	(8)
Profit before tax	245	132
Income tax expense	(80)	(32)
Profit for the year	165	100
Other comprehensive income:		
Items that may be reclassified to profit or loss:		
Gains on sale of investment	2	
Items that will not be reclassified to profit or loss:		
Revaluation of property, net of tax	60	20
Other comprehensive income for the year	62	20
Total comprehensive income	227	120

Additional information:

1. Zoo Limited acquired 40% of the equity share capital of Niqe Limited for Sh.270 million in the year 2014 when the fair value of the net assets of Niqe Limited was Sh.600 million. Zoo Limited acquired a further 30% of the equity share capital of Niqe Limited for Sh.260 million on 1 October 2017 when the fair value of the net assets was Sh.800 million. The fair value of the initial 40% investment in Niqe Limited was Sh.390 million as at 1 October 2017. There has been no impairment of the investments in Niqe Limited.
2. Assume that profits, gains and losses accrue evenly throughout the year.
3. It is the group's policy to measure the non-controlling interest at its proportionate share of the fair value of the net assets acquired.

Required:
Group consolidated income statement and other comprehensive income for the year ended 31 December 2017.
(10 marks)
(Total: 20 marks)

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Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	9901	.9804	.9709	9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	8772	.8696	.8621	8475	.8333	8065	7813	7576	7353
2	.9803	.9612	.9426	9246	.9070	.8900	8734	.8573	.8417	.8264	7972	7695	.7561	.7432	.7182	.6944	.6504	.6104	5739	5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	6750	6575	.6407	.6086	.5787	.5245	.4768	4348	3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	5921	.5718	.5523	.5158	.4823	.4230	.3725	3294	2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	6806	.6499	.6209	.5674	5194	.4972	.4761	.4371	.4019	.3411	2910	2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	3349	.2751	.2274	1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	:1776	1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	3075	.2843	.2630	.2255	1938	.1443	.1084	.0822	0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	3855	.3220	.2697	2472	.2267	.1911	.1615	.1164	.0847	.0623	0462
11	8963	8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	3555	.3186	.2567	.2076	.1869	1685	1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	8613	.7430	.6419	.5553	.4810	.4173	.3624	3152	.2745	.2394	.1827	1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	1069	.0930	0708	.0541	.0320	.0193	.0118	0073
17	8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	0168	.0092	.0051	0029
20	8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	1486	1037	.0728	.0611	.0514	.0365	0261	.0135	.0072	.0039	.0021
25	.7798	.6095	4776	.3751	.2953	.2330	.1842	1460	.1160	.0923	.0588	0378	.0304	.0245	0160	0105	.0046	.0021	.0010	0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	0196	.0151	.0116	.0070	.0042	.0016	0006	.0002	.0001
40	.6717	.4529	3066	.2083	.1420	.0972	.0668	0460	.0318	.0221	.0107	.0053	.0037	.0026	0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	0134	.0085	.0035	.0014	0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1 - \frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4541	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 26 November 2015. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Explain three components of management commentary in a company's annual report to shareholders. (6 marks)

(b) The auditors of Global Meridian Investment Limited discovered that certain items had been included in the inventory of the company as at 31 October 2015. These items which were valued at Sh.4.2 million had in fact been sold before the end of the year.

The following are the extracts of the income statements of Global Meridian Investment Limited for the year ended 31 October 2014 and 31 October 2015:

Statement of comprehensive income for the year ended 31 October:

	2014	2015
	Sh. "000"	Sh. "000"
Revenue	47,400	67,200
Cost of goods sold	(34,570)	(55,800)
Profit before tax	12,830	11,400
Income tax expense	(3,880)	(3,400)
Net profit	8,950	8,000

Additional information:

1. The retained profits as at 1 November 2013 amounted to Sh.13 million.
2. The cost of goods sold for the year ended 31 October 2015 includes an error of Sh.4.2 million in the opening inventory.
3. The corporation income tax rate for 2014 and 2015 was 30%.

Required:

(i) Comparative income statement for the year ended 31 October 2015. (6 marks)

(ii) Retained earnings for the year ended 31 October 2015. (4 marks)

(c) During the financial year ended 31 October 2010, Walnut Ltd. issued the following two financial instruments:

1. Redeemable preference shares with a coupon rate of 8%. The shares are redeemable on 31 October 2016 at a premium of 10%.
2. A grant of share options to senior executives. The options may be exercised from 31 October 2015.

Required:

For each of the instruments, identify whether it should be classified as debt or equity. Justify your choice citing the relevant provision of International Accounting Standards or International Financial Reporting Standards. (4 marks)

(Total: 20 marks)

QUESTION TWO

One of your clients, Best Limited, invested in 50% of the ordinary share capital of Fist Limited several years ago. The management has presented you with the following financial statements of the two companies for the year ended 31 May 2015:

Income statement for year ended 31 May 2015:

	Best Limited	Fist Limited
	Sh. "million"	Sh. "million"
Revenue	10,500	8,600
Cost of sales	(4,200)	(3,100)
Gross profit	6,300	5,500

	Sh. "million"	Sh. "million"
Expenses:		
Distribution costs	(1,400)	(2,000)
Administrative expenses	(1,050)	(2,980)
Finance cost	(200)	(100)
Profit before tax	3,650	420
Income tax expense	(1,050)	(120)
Profit for the period	2,600	300
Dividends paid	(500)	-
Profit for the year	2,100	300
Retained profits brought forward	1,400	1,000
Retained profits carried forward	3,500	1,300

Statement of financial position as at 31 May 2015:

	Best Limited Sh. "million"	Fist Limited Sh. "million"
Non-current assets		
Property, plant and equipment	5,000	2,100
Investment in Fist Limited	450	-
Other investments	300	200
	5,750	2,300
Current assets		
Inventory	2,650	350
Trade receivables	1,200	650
Cash at bank	600	200
	4,450	1,200
Total assets	10,200	3,500
Equity and liabilities		
Equity		
Ordinary share capital	4,000	500
Retained profits	3,500	1,300
Shareholders' funds	7,500	1,800
Non-current liabilities		
10% loan stock	2,000	1,000
Current liabilities		
Trade payables	650	600
Current tax	50	100
	700	700
Total equity and liabilities	10,200	3,500

Additional information:

1. Best Limited acquired Fist Limited when the retained profits of Fist Limited amounted to Sh.300 million. There was no fair value adjustments.
2. During the year, the inter-company sales between Best Limited and Fist Limited amounted to Sh.200 million. None of these goods were remaining in the inventory.
3. As at 31 May 2015, Best Limited owed Fist Limited Sh.40 million.
4. Goodwill arising on the acquisition of Fist Limited has not been impaired in the past but in the current year, the management of Best Limited feels there should be a 20% impairment.

Required:

(a) Prepare in columnar form, the financial statements of Best Limited assuming that the investment in Fist Limited should be accounted for using:

(i) Proportional consolidation method. (6 marks)

(ii) Equity method. (6 marks)

(b) Compute the following ratios for each of the methods identified in (a) (i) and (ii) above:

(i) Net profit margin. (2 marks)

(ii) Return on equity. (2 marks)

(iii) Gearing ratio. (2 marks)

(c) Comment on the results obtained in (b) (i) to (iii) above. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Outline four applications of financial statements forecasting. (4 marks)

(b) The following financial statements relate to Alpha Limited and Omega Limited for the year ended 31 October 2015:

	Alpha Limited		**Omega Limited**	
	Sh. "million"	**Sh. "million"**	**Sh. "million"**	**Sh. "million"**
Sales		4,000		6,000
Cost of sales				
Opening inventory	200		800	
Purchases	3,200		4,800	
	3,400		5,600	
Closing inventory	(400)	(3,000)	(800)	(4,800)
Gross profit		1,000		1,200
Expenses				
Distribution Costs	200		150	
Administrative expenses	290		250	
Finance cost	10	(500)	400	(800)
Profit before tax		500		400
Income tax expense		(120)		(90)
Profit after tax		380		310
Dividends paid		(150)		(100)
Retained profit for the year		230		210
Retained profit brought forward		220		2,480
Retained profit carried forward		450		2,690

Statement of financial position as at 31 October 2015:

	Alpha Limited		**Omega Limited**	
	Sh. "million"	**Sh. "million"**	**Sh. "million"**	**Sh. "million"**
Non-current assets				
Land and Buildings	1,200		5,000	
Furniture and motor vehicle	600	1,800	1,000	6,000
Current assets				
Inventory	400		800	
Trade receivables	850		750	
Financial assets	100		230	
Cash at bank	-	1,350	100	1,880
Total assets		3,150		7,880
Equity and liabilities				
Equity				
Ordinary shares		1,000		1,600
Retained profits		450		2,690
		1,450		4,290
Non-current liabilities				
Bank loans		500		3,000
Current liabilities				
Trade payables	1,080		590	
Bank overdraft	120	1,200	-	590
		3,150		7,880

Required:

(i) Common size percentage income statement for the year ended 31 October 2015. (7 marks)

(ii) Common size percentage statement of financial position as at 31 October 2015. (7 marks)

(iii) Comment on the profitability and gearing of the two companies based on the results obtained in (b) (i) and (ii) above. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Outline four factors that could be considered in determining an entity's functional currency as per International Accounting Standard, IAS 21 - The effects of changes in foreign exchange rates. (4 marks)

(b) ABC Ltd. formed a subsidiary in a foreign country on 1 January 2014 through a combination of debt and equity financing. The foreign subsidiary acquired land on 1 January 2014 which it rents to a local farmer. The foreign subsidiary's financial statements for its first year of operations, in foreign currency units (FC), are as follows:

Foreign subsidiary statement of comprehensive income:

	2014 FC (million)
Rent revenue	1,000
Interest expense	(250)
Net income	750

Foreign subsidiary statement of financial position:

	1 January 2014 FC (million)	**31 December 2014 FC (million)**
Cash	1,000	1,750
Land	9,000	9,000
Total assets	10,000	10,750
5% notes payable	5,000	5,000
Ordinary share capital	5,000	5,000
Retained earnings	-	750
Total equity and liabilities	10,000	10,750

Additional information:

1. The foreign country experienced significant inflation in 2014, especially in the second half of the year. The general price index during 2014 was as follows:

1 January 2014	100
Average 2014	125
31 December 2014	200

2. The rate of inflation in 2014 was 100% and the foreign country clearly meets the definition of a highly inflationary economy under International Financial Reporting Standards, IFRSs.

3. As a result of the high rate of inflation in the foreign country, the FC weakened substantially during the year relative to other currencies. Relevant exchange rates between ABC Ltd's presentation currency, Kenya Shilling (KES) and the FC during 2014 were as follows:

	KES per FC
1 January 2014	1.00
Average 2014	0.80
31 December 2014	0.50

Required:

The amounts that ABC Ltd. will include in its consolidated financial statements for the year ended 31 December 2014 related to the foreign subsidiary. (8 marks)

(c) The following financial data was extracted from the books of Signtex Limited for the year ended 31 December 2014:

	Sh. "000"
Current tax liability brought forward from the year 2013	102,300
Liability agreed during the year 2014	107,340
Estimated tax liability for year 2014	123,675
Deferred tax liability brought forward from the year 2013	82,254
Tax written down value of non-current assets	2,420,580
Carrying value of non-current assets	2,742,840

The corporation tax rate is 30%

Required:
(i) The taxation charge to be included in the income statement for the year ended 31 December 2014. (6 marks)

(ii) The amounts to be reported on the statement of financial position at the end of the year 2014, indicating how these amounts should be reported. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Identity five warnings signs that might alert financial analysts and investors of low quality revenue reporting. (5 marks)

(b) The following information relates to Athi Limited:

1. The company contributes Sh.42 million per annum to a pension scheme and treats the amount as current service cost pension expense.
2. On 1 July 2015, the actuarial valuation of the scheme showed a deficit of Sh.840 million.
3. The actuary recommended that the deficit be cleared within 4 years by paying Sh.210 million per annum in addition to the annual service costs.
4. The average remaining service years of the employees in the scheme on 1 July 2015 was 8 years.

Required:
For each of the remaining 8 years, calculate the pension expense and the pension liability or assets. (5 marks)

(c) The following summarised information is available in relation to Flamingo Ltd., a publicly listed company:

Income statement extract for the years ended 31 March:

	2015		2014	
	Continuing Operations Sh. "000"	**Discontinued Operations Sh. "000"**	**Continuing Operations Sh. "000"**	**Discontinued Operations Sh. "000"**
Profit after tax:				
• Existing operations	2,000	(750)	1,750	600
• Operations acquired on 1 August 2013	450		nil	

Additional information:

1. Analysts expects profits from the market sector in which Flamingo Ltd. existing operations are based to increase by 6% in the year to 31 March 2016 and by 8% in the sector of its newly acquired operations.
2. On 1 April 2013, Flamingo Ltd. had the following financial instruments:
   - Sh.6 million Sh.0.5 equity shares in issue.
   - Sh.5 million 8% convertible loan stock redeemable in the year 2020: the terms of conversion are 40 equity shares in exchange for each Sh.100 of loan stock.
3. On 1 October 2014, the directors of Flamingo Ltd. were granted option to buy 2 million shares in the company for Sh.15 each. The average market price of Flamingo Ltd. shares for the year ending 31 March 2015 was Sh.30 each.
4. Assume a corporation tax rate of 30%.

Required:
(i) Estimated profit after tax for the year ending 31 March 2016. Assuming the analysts expectations prove correct. (2 marks)

(ii) Basic and diluted earnings per shares (EPS) on the continuing operations of Flamingo Ltd. for the year ended 31 March 2015 and the comparatives for the year 2014. (8 marks)

(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 2 September 2021. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) As a financial research analyst, discuss five sources of information that one could use to assess the risks faced by a company. (10 marks)

(b) Toiz Ltd. is a manufacturer of toys. The company's annual report for the year 2020 contained the following footnote under Accounting Policies:

Promotional displays: The company's investment in promotional displays is carried at cost less applicable amortisation. Amortisation is provided using the straight line method on an individual display basis over the estimated period of benefit (approximately 30 months).

Toiz Ltd. provided the following financial information for the years ended 31 December:

	2019 Sh."000"	2020 Sh."000"
Promotional displays	8,451	10,099
Total assets	140,609	166,656
Shareholders' equity	78,337	92,612
Sales	327,013	387,301
Net income	17,509	14,467

Tax rate is 30%.

Required:

(i) Explain two reasons why Toiz Ltd. might have chosen to capitalise the cost of promotional displays rather than expense them. (4 marks)

(ii) Calculate the effect of capitalisation of promotional displays on the following reported amounts for the year ended 31 December 2020:

- Net income. (2 marks)
- Shareholders' equity. (2 marks)
- Return on assets. (2 marks)

(Total: 20 marks)

QUESTION TWO

The following financial statements were extracted from the books of Urban Ltd:

Urban Ltd.
Statement of profit or loss for the year ended 31 December 2020

	Sh."000"	Sh."000"
Net sales		30,500
Cost of goods sold		(17,600)
		12,900
Interest income		500
		13,400

Expenses:	Sh."000"	Sh."000"
Selling and administrative expenses	3,550	
Depreciation and amortisation expenses	1,890	(5,440)
Net profit before interest and tax		7,960
Interest expense		(900)
Net profit before tax		7,060
Income tax		(2,800)
Net profit		4,260

Urban Ltd.
Statement of financial position as at 31 December:

	2020	2019
Non-current assets:	**Sh."000"**	**Sh."000"**
Property, plant and equipment	7,100	7,000
Current assets:		
Cash	400	500
Short term investments	300	200
Accounts receivable	3,200	2,900
Inventory	6,000	5,400
	9,900	9,000
Total assets	17,000	16,000
Equity and liabilities:		
Equity		
Ordinary share capital of Sh.10 each	2,700	2,700
Share premium	1,000	1,000
Retained earnings	5,000	4,900
Total equity	8,700	8,600
Non-current liabilities:		
Long-term loan	2,000	1,800
Current liabilities:		
Accounts payable	3,700	3,400
Income tax payable	900	800
Accrued expenses	1,700	1,400
	6,300	5,600
Total equity and liabilities	17,000	16,000

The following financial ratios were extracted from Urban Ltd.'s books and compared to the industry average:

		Urban Ltd.		Industry Average
		2019	2018	(Current)
(i)	Current ratio	1.61	1.62	1.63
(ii)	Quick ratio	0.64	0.63	0.68
(iii)	Time interest earned	8.55	8.50	8.45
(iv)	Profit margin on sales	13.2%	12.1%	13.0%
(v)	Asset turnover	1.84	1.83	1.84
(vi)	Inventory turnover	3.17	3.21	3.18

Required:

(a) Urban Ltd.'s ratios for the year ended 31 December 2020 as presented above. (6 marks)

(b) Using each of the ratios calculated in (a) above, analyse Urban Ltd.'s financial stability and operating efficiency. (12 marks)

(c) Highlight two limitations of ratio analysis. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Highlight four criteria that must be met in order to recognise revenue earned at the point of sale. (4 marks)

(b) The following are extracts from the financial statements of Jolly Ltd.

Statement of profit or loss and other comprehensive income for the year ended 31 March 2021

	Sh."000"
Sales	11,480
Cost of sales	(9,680)
Gross profit	1,800
Income from gains on investment property	120
Distribution costs	(240)
Administrative cost	(700)
Finance cost	(100)
Profit before tax	880
Income tax expenses	(320)
Profit for the year	560
Other comprehensive income:	
Gains on property revaluation	200
Total comprehensive income	760

Statement of financial position

	31 March 2021		31 March 2020	
Assets:	Sh."000"	Sh."000"	Sh."000"	Sh."000"
Non-current assets:				
Property, plant and equipment		5,760		3,720
Investment property		840		800
		6,600		4,520
Current assets:				
Inventory	2,420		1,620	
Trade receivables	960		1,080	
Income tax asset	-		100	
Bank	20	3,400	-	2,800
Total assets		10,000		7,320
Equity and liabilities:				
Equity:				
Ordinary shares of Sh.2 each		2,000		1,200
Share premium	1,200		-	
Revaluation reserve	300		100	
Retained earnings	2,880	4,380	2,620	2,720
		6,380		3,920
Non-current liabilities:				
6% loan notes	-		800	
Deferred tax	100	100	60	860
Current liabilities:				
Trade payables	2,820		2,100	
Bank overdraft	-		240	
Warranty provision	400		200	
Current tax payable	300	3,520	-	2,540
Total equity and liabilities		10,000		7,320

Additional information:

1. An item of plant with a carrying amount of Sh.480,000 was sold at a loss of Sh.180,000 during the year ended 31 March 2021. Depreciation of Sh.560,000 was charged (to cost of sales) for property, plant and equipment in the year ended 31 March 2021. There are no purchases or sales of investment property during the year.
2. The 6% loan notes were redeemed early incurring a penalty payment of Sh.40,000. This amount was charged as an administrative expense in the income statement.
3. There was an issue of shares on 1 October 2020. There was no bonus issue during the year.
4. Jolly Ltd. gives a twelve month warranty on some of the products it sells. The amount shown in current liabilities warranty provision is an accurate assessment based on past experience of the amount of claims likely to be made in respect of warranties outstanding at each year end. Warranty costs are included in cost of sales.
5. A dividend of Sh.0.3 per share was paid on 1 January 2021.

Required:
Statement of cash flows for the year ended 31 March 2021 in accordance with International Accounting Standard (IAS) 7, "Statement of Cash Flows".

(16 marks)
(Total: 20 marks)

QUESTION FOUR

(a) Discuss three barriers that could hinder harmonisation of international financial reporting standards. (6 marks)

(b) The income statements for MG Ltd., RG Ltd and CG Ltd. for the year ended 31 December 2020 are shown below:

	MG Ltd. Sh."000"	RG Ltd. Sh."000"	CG Ltd. Sh."000"
Revenue	4,000	1,500	1,200
Cost of sales	(2,300)	(1,000)	(800)
Gross profit	1,700	500	400
Distribution costs	(900)	(120)	(80)
Administrative expenses	(350)	(150)	(100)
Other income	70	-	-
Profit before tax	520	230	220
Income tax expense	(250)	(80)	(100)
Profit for the year	270	150	120

Additional information:

1. MG Ltd. acquired 70% of the ordinary share capital of RG Ltd. on 1 January 2019 for Sh.8,200,000. At the date of acquisition, the net assets of RG Ltd. were assessed to have a fair value of Sh.10,000,000. The only fair value adjustment required on acquisition related to depreciable assets (see note 2 below). The group policy is to value non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interest at the date of acquisition was Sh.2,200,000.
2. At the date of acquisition, depreciable assets of RG Ltd. with a remaining useful life of 6 years, had a fair value of Sh.240,000 more than their book value. The group policy is to depreciate non-current assets on a straight line basis over the remaining economic useful life. Depreciation is to be charged to administrative expenses.
3. No impairment of goodwill arose in the year ended 31 December 2019. However, an impairment, review conducted on 31 December 2020 showed goodwill being impaired by 15%. Impairment losses are to be charged to administrative expenses.
4. MG Ltd. acquired 40% of the ordinary share capital of CG Ltd. on 1 October 2020. MG Ltd. is now able to exercise significant influence over the operating and financial policies of CG Ltd.
5. During the year ended 31 December 2020, MG Ltd. and RG Ltd. paid ordinary dividends of Sh.300,000 and Sh.100,000 respectively. Income from investments is included within other income.
6. RG Ltd. sold goods to MG Ltd. on 1 November 2020 with a sales value of Sh.140,000. Half of these goods remained in MG Ltd.'s inventories at the year end. RG Ltd. makes 20% profit margin on all sales.

Required:
Consolidated income statement for the MG group for the year ended 31 December 2020. (14 marks)
(Total: 20 marks)

QUESTION FIVE

(a) Evaluate two challenges that a financial analyst might encounter when using the equity method to account for associates and jointly controlled entities. (4 marks)

(b) Big Guy company is evaluating a lease arrangement being offered by Systemia Company for use of a computer system. The lease is non-cancellable, and in no case does Big Guy Company receive title to the computers during or at the end of the lease term. The lease will commence on 1 January 2022 with the first rental payment due on 1 January 2022.

Additional information relating to the lease is as follows:

Yearly rental	Sh.3,557,250
Lease term	3 years
Estimated economic life	5 years
Purchase option	Sh.3,000,000 at the end of 3 years, which approximates fair value

Renewal option	1 year at Sh.1,500,000, no penalty for non renewal; standard renewal clause
Fair value at inception of lease	Sh.10,000,000
Cost of asset to lessor	Sh.10,000,000
Residual value:	
Guaranteed	0
Unguaranteed	Sh.3,000,000
Lessor's implicit rate (known by the lessee)	12%
Executory costs paid by lessor:	Estimated to be Sh.500,000 per year (included in rental equipment)
Estimated fair value at the end of lease	Sh.3,000,000

Required:
Using the four criteria for capitalisation of leases, analyse the above lease arrangement. (6 marks)

(c) The following financial information was extracted from the books of Jaxx Ltd.:

Long term debt	**Sh.**
Notes payable, 10%	1,000,000
8% convertible bonds payable	5,000,000
10% bonds payable	6,000,000
Total long term debt	12,000,000
Shareholders' equity	
Preference shares, 6% cumulative, Sh.50 par value 100,000 shares authorised, 25,000 shares issued and outstanding	1,250,000
Ordinary shares Sh.1 par, 10,000,000 shares authorised, 1,000,000 shares issued and outstanding	1,000,000
Additional paid in capital	4,000,000
Retained earnings	6,000,000
Total shareholders' equity	12,250,000

Additional information:
1. Options were granted on 1 January 2020 to purchase 200,000 shares at Sh.15 per share. Although no options were exercised during the financial year 2020, the average price per ordinary share during the financial year 2020 was Sh.20 per share.
2. Each bond was issued at face value. The 8% convertible bond will convert into ordinary shares at 50 shares per Sh.1,000 bond. The bonds were exercisable after 5 years and were issued in 2019.
3. The preference shares was issued in 2019.
4. There are no preference dividend in arrears; however, preference dividends were not declared in the year ended 31 December 2020.
5. The 1,000,000 ordinary shares were outstanding for the entire year 2020.
6. The net income for the year ended 31 December 2020 was Sh.1,500,000 and the tax rate is 30%.

Required:
For the year ended 31 December 2020, calculate the following:

(i) Basic earnings per share (BEPS). (2 marks)

(ii) Diluted earnings per share (DEPS). (6 marks)

(d) Explain how the conversion feature of convertible debt has value:

(i) To the issuer. (1 marks)

(ii) To the purchaser. (1 mark)

(Total: 20 marks)

Present Value Interest factor of 1 Received at the End of *n* Periods at r Percent:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	20%	24%	25%	30%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8333	0.8065	0.8000	0.7692
2	0.9803	0.9612	0.9426	0.9246	0.9070	0.8900	0.8734	0.8573	0.8417	0.8264	0.8116	0.7972	0.7831	0.7695	0.7561	0.7432	0.6944	0.6504	0.6400	0.5917
3	0.9706	0.9423	0.9151	0.8890	0.8638	0.8396	0.8163	0.7938	0.7722	0.7513	0.7312	0.7118	0.6931	0.6750	0.6575	0.6407	0.5787	0.5245	0.5120	0.4552
4	0.9610	0.9238	0.8885	0.8548	0.8227	0.7921	0.7629	0.7350	0.7084	0.6830	0.6587	0.6355	0.6133	0.5921	0.5718	0.5523	0.4823	0.4230	0.4096	0.3501
5	0.9515	0.9057	0.8626	0.8219	0.7835	0.7473	0.7130	0.6806	0.6499	0.6209	0.5935	0.5674	0.5428	0.5194	0.4972	0.4761	0.4019	0.3411	0.3277	0.2693
6	0.9420	0.8880	0.8375	0.7903	0.7462	0.7050	0.6663	0.6302	0.5963	0.5645	0.5346	0.5066	0.4803	0.4556	0.4323	0.4104	0.3349	0.2751	0.2621	0.2072
7	0.9327	0.8706	0.8131	0.7599	0.7107	0.6651	0.6227	0.5835	0.5470	0.5132	0.4817	0.4523	0.4251	0.3996	0.3759	0.3538	0.2791	0.2218	0.2097	0.1594
8	0.9235	0.8535	0.7894	0.7307	0.6768	0.6274	0.5820	0.5403	0.5019	0.4665	0.4339	0.4039	0.3762	0.3506	0.3269	0.3050	0.2326	0.1789	0.1678	0.1226
9	0.9143	0.8368	0.7664	0.7026	0.6446	0.5919	0.5439	0.5002	0.4604	0.4241	0.3909	0.3606	0.3329	0.3075	0.2843	0.2630	0.1938	0.1443	0.1342	0.0943
10	0.9053	0.8203	0.7441	0.6756	0.6139	0.5584	0.5083	0.4632	0.4224	0.3855	0.3522	0.3220	0.2946	0.2697	0.2472	0.2267	0.1615	0.1164	0.1074	0.0725
11	0.8963	0.8043	0.7224	0.6496	0.5847	0.5268	0.4751	0.4289	0.3875	0.3505	0.3173	0.2875	0.2607	0.2366	0.2149	0.1954	0.1346	0.0938	0.0859	0.0558
12	0.8874	0.7885	0.7014	0.6246	0.5568	0.4970	0.4440	0.3971	0.3555	0.3186	0.2858	0.2567	0.2307	0.2076	0.1869	0.1685	0.1122	0.0757	0.0687	0.0429
13	0.8787	0.7730	0.6810	0.6006	0.5303	0.4688	0.4150	0.3677	0.3262	0.2897	0.2575	0.2292	0.2042	0.1821	0.1625	0.1452	0.0935	0.0610	0.0550	0.0330
14	0.8700	0.7579	0.6611	0.5775	0.5051	0.4423	0.3878	0.3405	0.2992	0.2633	0.2320	0.2046	0.1807	0.1597	0.1413	0.1252	0.0779	0.0492	0.0440	0.0254
15	0.8613	0.7430	0.6419	0.5553	0.4810	0.4173	0.3624	0.3152	0.2745	0.2394	0.2090	0.1827	0.1599	0.1401	0.1229	0.1079	0.0649	0.0397	0.0352	0.0195
16	0.8528	0.7284	0.6232	0.5339	0.4581	0.3936	0.3387	0.2919	0.2519	0.2176	0.1883	0.1631	0.1415	0.1229	0.1069	0.0930	0.0541	0.0320	0.0281	0.0150
17	0.8444	0.7142	0.6050	0.5134	0.4363	0.3714	0.3166	0.2703	0.2311	0.1978	0.1696	0.1456	0.1252	0.1078	0.0929	0.0802	0.0451	0.0258	0.0225	0.0116
18	0.8360	0.7002	0.5874	0.4936	0.4155	0.3503	0.2959	0.2502	0.2120	0.1799	0.1528	0.1300	0.1108	0.0946	0.0808	0.0691	0.0376	0.0208	0.0180	0.0089
19	0.8277	0.6864	0.5703	0.4746	0.3957	0.3305	0.2765	0.2317	0.1945	0.1635	0.1377	0.1161	0.0981	0.0829	0.0703	0.0596	0.0313	0.0168	0.0144	0.0068
20	0.8195	0.6730	0.5537	0.4564	0.3769	0.3118	0.2584	0.2145	0.1784	0.1486	0.1240	0.1037	0.0868	0.0728	0.0611	0.0514	0.0261	0.0135	0.0115	0.0053
21	0.8114	0.6598	0.5375	0.4388	0.3589	0.2942	0.2415	0.1987	0.1637	0.1351	0.1117	0.0926	0.0768	0.0638	0.0531	0.0443	0.0217	0.0109	0.0092	0.0040
22	0.8034	0.6468	0.5219	0.4220	0.3418	0.2775	0.2257	0.1839	0.1502	0.1228	0.1007	0.0826	0.0680	0.0560	0.0462	0.0382	0.0181	0.0088	0.0074	0.0031
23	0.7954	0.6342	0.5067	0.4057	0.3256	0.2618	0.2109	0.1703	0.1378	0.1117	0.0907	0.0738	0.0601	0.0491	0.0402	0.0329	0.0151	0.0071	0.0059	0.0024
24	0.7876	0.6217	0.4919	0.3901	0.3101	0.2470	0.1971	0.1577	0.1264	0.1015	0.0817	0.0659	0.0532	0.0431	0.0349	0.0284	0.0126	0.0057	0.0047	0.0018
25	0.7798	0.6095	0.4776	0.3751	0.2953	0.2330	0.1842	0.1460	0.1160	0.0923	0.0736	0.0588	0.0471	0.0378	0.0304	0.0245	0.0105	0.0046	0.0038	0.0014
30	0.7419	0.5521	0.4120	0.3083	0.2314	0.1741	0.1314	0.0994	0.0754	0.0573	0.0437	0.0334	0.0256	0.0196	0.0151	0.0116	0.0042	0.0016	0.0012	*
35	0.7059	0.5000	0.3554	0.2534	0.1813	0.1301	0.0937	0.0676	0.0490	0.0356	0.0259	0.0189	0.0139	0.0102	0.0075	0.0055	0.0017	0.0005	*	*
36	0.6989	0.4902	0.3450	0.2437	0.1727	0.1227	0.0875	0.0626	0.0449	0.0323	0.0234	0.0169	0.0123	0.0089	0.0065	0.0048	0.0014	*	*	*
40	0.6717	0.4529	0.3066	0.2083	0.1420	0.0972	0.0668	0.0460	0.0318	0.0221	0.0154	0.0107	0.0075	0.0053	0.0037	0.0026	0.0007	*	*	*
50	0.6080	0.3715	0.2281	0.1407	0.0872	0.0543	0.0339	0.0213	0.0134	0.0085	0.0054	0.0035	0.0022	0.0014	0.0009	0.0006	*	*	*	*

Present Value Interest factors for Annuity of 1 Discounted at r Percent for *n* Periods:

$$PVIFA_{r,n} = [1 - 1/(1+r)^n]/r$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	20%	24%	25%	30%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8333	0.8065	0.8000	0.7692
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.7125	1.6901	1.6681	1.6467	1.6257	1.6052	1.5278	1.4568	1.4400	1.3609
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4437	2.4018	2.3612	2.3216	2.2832	2.2459	2.1065	1.9813	1.9520	1.8161
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.1024	3.0373	2.9745	2.9137	2.8550	2.7982	2.5887	2.4043	2.3616	2.1662
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6959	3.6048	3.5172	3.4331	3.3522	3.2743	2.9906	2.7454	2.6893	2.4356
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.2305	4.1114	3.9975	3.8887	3.7845	3.6847	3.3255	3.0205	2.9514	2.6427
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.7122	4.5638	4.4226	4.2883	4.1604	4.0386	3.6046	3.2423	3.1611	2.8021
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	5.1461	4.9676	4.7988	4.6389	4.4873	4.3436	3.8372	3.4212	3.3289	2.9247
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.5370	5.3282	5.1317	4.9464	4.7716	4.6065	4.0310	3.5655	3.4631	3.0190
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.8892	5.6502	5.4262	5.2161	5.0188	4.8332	4.1925	3.6819	3.5705	3.0915
11	10.368	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	6.2065	5.9377	5.6869	5.4527	5.2337	5.0286	4.3271	3.7757	3.6564	3.1473
12	11.255	10.575	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.4924	6.1944	5.9176	5.6603	5.4206	5.1971	4.4392	3.8514	3.7251	3.1903
13	12.134	11.348	10.635	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.7499	6.4235	6.1218	5.8424	5.5831	5.3423	4.5327	3.9124	3.7801	3.2233
14	13.004	12.106	11.296	10.563	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.9819	6.6282	6.3025	6.0021	5.7245	5.4675	4.6106	3.9616	3.8241	3.2487
15	13.865	12.849	11.938	11.118	10.380	9.7122	9.1079	8.5595	8.0607	7.6061	7.1909	6.8109	6.4624	6.1422	5.8474	5.5755	4.6755	4.0013	3.8593	3.2682
16	14.718	13.578	12.561	11.652	10.838	10.106	9.4466	8.8514	8.3126	7.8237	7.3792	6.9740	6.6039	6.2651	5.9542	5.6685	4.7296	4.0333	3.8874	3.2832
17	15.562	14.292	13.166	12.166	11.274	10.477	9.7632	9.1216	8.5436	8.0216	7.5488	7.1196	6.7291	6.3729	6.0472	5.7487	4.7746	4.0591	3.9099	3.2948
18	16.398	14.992	13.754	12.659	11.690	10.828	10.059	9.3719	8.7556	8.2014	7.7016	7.2497	6.8399	6.4674	6.1280	5.8178	4.8122	4.0799	3.9279	3.3037
19	17.226	15.678	14.324	13.134	12.085	11.158	10.336	9.6036	8.9501	8.3649	7.8393	7.3658	6.9380	6.5504	6.1982	5.8775	4.8435	4.0967	3.9424	3.3105
20	18.046	16.351	14.877	13.590	12.462	11.470	10.594	9.8181	9.1285	8.5136	7.9633	7.4694	7.0248	6.6231	6.2593	5.9288	4.8696	4.1103	3.9539	3.3158
21	18.857	17.011	15.415	14.029	12.821	11.764	10.836	10.017	9.2922	8.6487	8.0751	7.5620	7.1016	6.6870	6.3125	5.9731	4.8913	4.1212	3.9631	3.3198
22	19.660	17.658	15.937	14.451	13.163	12.042	11.061	10.201	9.4424	8.7715	8.1757	7.6446	7.1695	6.7429	6.3587	6.0113	4.9094	4.1300	3.9705	3.3230
23	20.456	18.292	16.444	14.857	13.489	12.303	11.272	10.371	9.5802	8.8832	8.2664	7.7184	7.2297	6.7921	6.3988	6.0442	4.9245	4.1371	3.9764	3.3254
24	21.243	18.914	16.936	15.247	13.799	12.550	11.469	10.529	9.7066	8.9847	8.3481	7.7843	7.2829	6.8351	6.4338	6.0726	4.9371	4.1428	3.9811	3.3272
25	22.023	19.523	17.413	15.622	14.094	12.783	11.654	10.675	9.8226	9.0770	8.4217	7.8431	7.3300	6.8729	6.4641	6.0971	4.9476	4.1474	3.9849	3.3286
30	25.808	22.396	19.600	17.292	15.372	13.765	12.409	11.258	10.274	9.4269	8.6938	8.0552	7.4957	7.0027	6.5660	6.1772	4.9789	4.1601	3.9950	3.3321
35	29.409	24.999	21.487	18.665	16.374	14.498	12.948	11.655	10.567	9.6442	8.8552	8.1755	7.5856	7.0700	6.6166	6.2153	4.9915	4.1644	3.9984	3.3330
36	30.108	25.489	21.832	18.908	16.547	14.621	13.035	11.717	10.612	9.6765	8.8786	8.1924	7.5979	7.0790	6.6231	6.2201	4.9929	4.1649	3.9987	3.3331
40	32.835	27.355	23.115	19.793	17.159	15.046	13.332	11.925	10.757	9.7791	8.9511	8.2438	7.6344	7.1050	6.6418	6.2335	4.9966	4.1659	3.9995	3.3332
50	39.196	31.424	25.730	21.482	18.256	15.762	13.801	12.233	10.962	9.9148	9.0417	8.3045	7.6752	7.1327	6.6605	6.2463	4.9995	4.1666	3.9999	3.3333

kasneb

CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 20 May 2021. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Bidii Cement Company is listed in the local securities market. Some of the other listed cement manufacturing companies provide extensive disclosures in their external reports about their environmental policies and practices.

Required:

(i) Discuss two reasons that may cause Bidii Cement Company to voluntarily disclose its environmental policies and practices as part of its annual reports. (4 marks)

(ii) Explain three potential advantages of voluntary environmental disclosures to Bidii Cement Company. (6 marks)

(b) Milele Ltd. is a public limited company. As at 31 March 2019, Milele Ltd. had issued share capital of Sh.10 million. The shares are denominated at Sh.0.25 each. Milele Ltd.'s earnings attributable to its ordinary shareholders for the year ended 31 March 2019 were also Sh.10 million giving an earning per share of Sh.0.25.

The following transactions took place during the year ended 31 March 2020:

1. On 1 July 2019, Milele Ltd. issued eight million ordinary shares at full market value.
2. On 1 January 2020, a bonus issue of one ordinary share for every four ordinary shares held was made.
3. Earnings attributable to ordinary shareholders for the year ended 31 March 2020 were Sh.13,800,000.

Transactions for the year ended 31 March 2021 were as follows:

1. On 1 October 2020, Milele Ltd. made a rights issue of share of two new ordinary shares at a price of Sh.1.00 each for every five ordinary shares held. The offer was fully subscribed.
2. The market price of Milele Ltd. ordinary shares immediately prior to the offer was Sh.2.40.
3. Earning attributable to ordinary shareholders for the year ended 31 March 2021 were Sh.19,500,000.

Required:

(i) Earning per share (EPS) for the year ended 31 March 2020 including comparative figure for the year ended 31 March 2019. (4 marks)

(ii) Earning per share (EPS) for the year ended 31 March 2021 including comparative figure for the year ended 31 March 2020. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) Operating segment information in a set of financial statements has been viewed by some investors as just too much information which may be difficult to understand. Some investors argue that this information is also costly to produce and its cost outweighs its benefits.

Required:

(i) Describe three benefits that could be derived by investors from reviewing the operating segment disclosures accompanying financial statements when making decisions on investments. (6 marks)

(ii) Explain two limitations of using operating segment information when making investment decisions. (4 marks)

(b) Drible Cable (DC) experienced a period of rapid expansion in the six months following the launch of a new product on 1 July 2020. The following information is available from the books of DC:

	6 months to 31 December 2020 Sh."000"	6 months to 30 June 2020 Sh."000"
Inventories at period end	1,220	460
Receivables at period end	1,715	790
Cash and cash equivalents at period end	-	150
Trade payables at period end	1,190	580
Short-term borrowings at period end	250	-
Revenue for the period	3,100	2,000
Cost of sales for the period	2,420	1,450

Note:
Assume a 365-day year.

Required:
For each of the periods above, calculate the following ratios:

(i) Inventories turnover period. (1 mark)
(ii) Payables turnover period. (1 mark)
(iii) Receivables turnover period. (1 mark)
(iv) Current ratio. (1 mark)
(v) Quick ratio. (1 mark)
(vi) Gross profit margin. (1 mark)
(vii) Using the calculations in (b) (i) to (vi) above, comment on the financial performance of DC. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) Duka Limited owns a piece of machinery and entered into an agreement to lease the machinery on 1 January 2017. In the lease contract, the company requires four annual payment of Sh.28,679 starting on 1 January 2017. The present value of the lease payments using a 10% discount rate is Sh.100,000 and the fair value of the equipment is Sh.90,000. The useful life of the machinery is four years and its salvage value is zero.

Required:
(i) Duka Ltd.'s cumulative income related to the lease. (8 marks)

(ii) Distinguish between reporting a lease as an operating lease or as a finance lease in the financial statements.

(4 marks)

(iii) Jane Mara, a financial analyst is seeking to identify companies with potential unrecorded leases. She studied the 2020 annual report of Basket Ltd. which reported an operating lease from 2020 to 2025 as shown below:

Basket Ltd.
Operating lease payments

Year	Amount Sh."000"
2020	215
2021	186
2022	160
2023	141
2024	136
2025	136

Jane Mara noted that Basket Ltd. had issued a bond with an effective interest rate of 6% per annum.

Required:
The present value of the operating lease commitment. (4 marks)

(b) The following information relates to Minoh Ltd.'s pension plan as at 31 December 2020:

1. The present value of a company's defined benefit obligation is Sh.5,485 million and the fair value of the pension plan asset is Sh.5,798 million.
2. The company has unrecognised transition liabilities of Sh.50 million, unrecognised actuarial losses of Sh.59 million and unrecognised past service costs of Sh.70 million.
3. The present value of available future refunds and reductions in future contribution is Sh.313 million.

Required:
The amount of the pension asset to be reported as at 31 December 2020 in the statement of financial position. (4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) International Accounting Standard (IAS) 10, Events After the Reporting Period, shall be applied in the accounting for, and disclosure of, events after the reporting period.

Required:

(i) Explain the term "events after the reporting period". (2 marks)

(ii) Highlight two types of events that are identified under the standard. (2 marks)

(b) White Ltd. (WL) has a number of investments in subsidiary and associate entities. During the year ended 30 June 2020, WL acquired an investment in QB Ltd.

The statements of financial position of WL group for the years ended 30 June 2020 and 30 June 2019 are shown below:

	2020	2019
Assets:	**Sh."000"**	**Sh."000"**
Non-current assets:		
Property, plant and equipment	25,500	22,200
Goodwill	6,800	6,000
Investment in associate	6,200	5,700
	38,500	33,900
Current assets	42,500	42,950
Total assets	81,000	76,850
Equity and liabilities:		
Equity attributable to owners of the parent company's share capital (par value Sh.1)	18,000	15,000
Share premium	4,200	-
Revaluation reserve	1,000	-
Retained earnings	10,550	10,050
	33,750	25,050
Non controlling interests	9,750	9,100
Total equity	43,500	34,150
Non-current liabilities:		
Long-term borrowings	20,550	26,200
Current liabilities	16,950	16,500
Total liabilities	37,500	42,700
Total equity and liabilities	81,000	76,850

Additional information:

1. During the year ended 30 June 2020, there was no disposal of property, plant and equipment. Depreciation charged for the year ended 30 June 2020 was Sh.1,200,000.
2. WL's share of the associate's profit for the year ended 30 June 2020 was Sh.1,800,000.
3. The total comprehensive income attributable to non-controlling interest for the year ended 30 June 2020 was Sh.350,000.
4. WL acquired 75% of the equity share capital of QB on 1 January 2020 for a cash consideration of Sh.300,000 and the issue of 1,000,000 ordinary shares of Sh.1 each in WL. WL's shares had a deemed value of Sh.2.15 per share at the date of acquisition.

5. The fair value of the net assets of QB acquired on 1 January 2020 were as follows:

	Sh."000"
Property, plant and equipment	1,200
Inventories	1,700
Receivables	900
Cash and cash equivalents	200
Payables	(1,800)
Fair value of net assets	2,200

6. WL did not acquire or dispose of any other investments in the year. The group policy is to value non controlling interest at acquisition at its proportionate share of the fair value of the net assets acquired.
7. In the year ended 30 June 2020, QB paid a dividend but WL did not pay any dividend.

Required:
Extracts from the consolidated statement of cash flows for WL for:

(i) Cash flows from investing activities for the year ended 30 June 2020. (8 marks)

(ii) Cash flows from financing activities for the year ended 30 June 2020. (8 marks)
(Total: 20 marks)

QUESTION FIVE

(a) On 1 January 2020, Berry Ltd. acquired 90% of the outstanding shares of Cherry Ltd. in exchange for shares of Berry Ltd. with a fair value of Sh.180 million. The fair market value of Cherry Ltd.'s ordinary shares on the date of the exchange was Sh.200 million.

The following is a summary of the financial information of the two companies as at 31 December 2019:

	Berry Ltd.	**Cherry Ltd.**	
	Book value	**Book value**	**Fair value**
	Sh."000"	**Sh."000"**	**Sh."000"**
Cash and receivables	40,000	15,000	15,000
Inventory	125,000	80,000	80,000
Property, plant and equipment	235,000	95,000	155,000
	400,000	190,000	250,000
Payables	55,000	20,000	20,000
Long-term debt	120,000	70,000	70,000
	175,000	90,000	90,000
Net assets	225,000	100,000	160,000
Shareholders equity:			
Ordinary shares	87,000	34,000	
Retained earnings	138,000	66,000	
	225,000	100,000	

Required:

(i) The value of goodwill and the value of the non controlling interest on 1 January 2020 under the partial goodwill method. (3 marks)

(ii) Consolidated statement of financial position as at 1 January 2020. (7 marks)

(b) RTZ Ltd. operates in country N and has established the NSh as its functional currency. RTZ Ltd. acquired a piece of machinery from an international supplier on 20 November 2020. The invoice remained unpaid at the year ended 31 December 2020:

Relevant exchange rates (where NSh/KSh 2.00 means Nsh 1 = Ksh.2.00) are:

20 November 2020	Nsh/Ksh2.00
31 December 2020	Nsh/Ksh2.15

Required:
In accordance with International Accounting Standard (IAS) 21, The Effect of Changes in Foreign Exchange Rates:

(i) Distinguish between "functional currency" and "presentation currency". (4 marks)

(ii) Highlight two factors that RTZ Ltd. might have considered when establishing Nsh. as its functional currency. (2 marks)

(iii) Calculate the amounts to be included in the financial statements of RTZ Ltd. for the year ended 31 December 2020 in respect to the above transaction. (4 marks)

(Total: 20 marks)

....

Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	8772	.8696	.8621	.8475	.8333	.8065	.7813	7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	8573	.8417	.8264	.7972	.7695	7561	.7432	.7182	.6944	.6504	.6104	5739	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	1164	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	3152	.2745	.2394	.1827	1401	.1229	.1079	0835	.0649	.0397	.0247	.0155	0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	2145	1784	.1486	1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	0160	.0105	.0046	.0021	.0010	0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	3066	.2083	.1420	.0972	.0668	0460	.0318	.0221	.0107	0053	0037	.0026	.0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1-\frac{1}{(1+r)^n}}{r}$$

Number of Payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

kasneb

CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

FRIDAY: 27 November 2020. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) A company's financial statements are the most objective way to assess the health of an organisation.

With reference to the above statement:

(i) Identify four primary components of financial statements. (4 marks)

(ii) Examine four warning signs that might identify a financially distressed firm. (8 marks)

(b) Analysts frequently make adjustments to a company's reported financial statements when comparing those statements to those of another company which uses different accounting methods, estimates or assumptions.

In relation to the above statement, discuss four items in the statement of financial positon that might require adjustments for the purpose of comparison. (8 marks)

(Total: 20 marks)

QUESTION TWO

(a) Big Ltd. acquired 80% of the 1 million issued Sh.1 ordinary share capital of Small Ltd. on 1 May 2019 for Sh.1,750,000 when Small Ltd's earnings were Sh.920,000. Small Ltd.'s carrying value of Sh.1,920,000 was considered to be the same as fair value with the exception of the following:

- The carrying value of Small Ltd's property, plant and equipment as at 1 May 2019 was Sh.680,000. The market value at that date was estimated at Sh.745,000. The remaining useful life of the property, plant and equipment was estimated at 5 years from the date of acquisition.
- Small Ltd. had a contingent liability with a fair value of Sh.100,000. There was no change to the value of this liability at the year end.

Additional information:

1. Big Ltd. estimates that the cost of reorganising the combined entity following acquisition will be Sh.200,000.
2. Big Ltd. depreciates all assets on a straight line basis over the estimated useful life on a monthly basis.
3. Small Ltd. sold goods to Big Ltd. with a sales value of Sh.300,000 since the acquisition. All of these goods remain in Big Ltd.'s inventories at the year end. Small Ltd. makes 20% gross profit margin on all sales.
4. The retained earnings reported in the financial statements of Big Ltd. and Small Ltd. as at 31 December 2019 are Sh.3.2 million and Sh.1.1 million respectively. There has been no impairment to goodwill since the date of acquisition.
5. The group policy is to measure non-controlling interest at fair value at the date of acquisition. The fair value of non-controlling interest as at 1 May 2019 was Sh.320,000.

Required:

The amounts that will appear in the consolidated statement of financial position of Big group as at 31 December 2019 for:

(i) Goodwill. (3 marks)
(ii) Consolidated retained earnings. (4 marks)
(iii) Non-controlling interest. (3 marks)

(b) Jared Properties (JP) Ltd., a listed company had 10,000,000 ordinary Sh.1 shares in issue on 1 January 2019.

During the year, the following transactions took place:

1. On 1 April 2019, JP Ltd. made a 1 for 2 bonus share issue.
2. On 1 October 2019, JP Ltd. issued 2,000,000 ordinary Sh.1 shares at their full market price of Sh.7.60 per share. JP Ltd.'s shares were trading at Sh.8.05 per share on 31 December 2019.
3. JP Ltd.'s profit after tax for the year ended 31 December 2019 was Sh.8,200,000.
4. JP Ltd. issued a convertible debt instrument on 1 January 2019. The liability element of the instrument had a value of Sh.6,000,000 on 1 January 2019. The effective interest rate in respect of this liability was 5% per annum.
5. The effective tax rate is 30%.

Required:

(i) Basic earnings per share (BEPS) for the year ended 31 December 2019. (4 marks)

(ii) Diluted earnings per share (DEPS) for the year ended 31 December 2019. (4 marks)

(iii) Explain why bonus issue of shares and issue of shares at full market price are treated differently in the calculation of basic earnings per share. (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Explain four reasons why a company could change its accounting policies. (4 marks)

(b) The following is a summarised financial statement for Rinda Ltd. for the years ended 31 March 2019 and 31 March 2020:

Income statement for the year ended 31 March:

	2020 Sh."000"	2019 Sh."000"
Revenue	1,000,000	720,000
Cost of sales	(800,000)	(600,000)
Gross profit	200,000	120,000
Operating expenses	(104,000)	(88,000)
Finance costs	(32,000)	-
Profit before tax	64,000	32,000
Income tax expense (at 25%)	(16,000)	(8,000)
Profit for the year	48,000	24,000

Statement of financial positions as at 31 March:

	2020 Sh."000"	2019 Sh."000"
Non-current assets:		
Property, plant and equipment	840,000	360,000
Goodwill	40,000	-
	880,000	360,000
Current assets:		
Inventory	100,000	60,000
Trade receivables	52,000	32,000
Bank	-	56,000
	152,000	148,000
Total assets	1,032,000	508,000
Equity and liabilities:		
Equity shares of Sh.1 each	400,000	400,000
Retained earnings	56,000	48,000
	456,000	448,000
Non-current liabilities:		
8% loan notes	400,000	-
Current liabilities:		
Bank overdraft	68,000	-
Trade payables	92,000	52,000
Current tax payable	16,000	8,000
	176,000	60,000
Total equity and liabilities	1,032,000	508,000

Note: Assume a 365-day year.

Required:
Calculate the following ratios for the years ended 31 March 2019 and 31 March 2020:

(i) Return on capital employed. (2 marks)

(ii) Cash ratio (2 marks)

(iii) Net profit margin. (2 marks)

(iv) Current ratio. (2 marks)

(v) Closing inventory holding period. (2 marks)

(vi) Trade receivables collection period. (2 marks)

(vii) Trade payables payment period. (2 marks)

(viii) Gearing (debt/equity). (2 marks)

(Total: 20 marks)

QUESTION FOUR
On 1 July 2019, SM Ltd. acquired 60% of the equity share capital of NY Ltd. through a share exchange of two shares in SM Ltd. for three shares in NY Ltd. This issue of shares had not yet been recorded by SM Ltd.

Below are the summarised draft financial statements for both companies:

Income statements for the year ended 31 December 2019

	SM Ltd. Sh."000"	NY Ltd. Sh."000"
Revenue	85,000	42,000
Cost of sales	(63,000)	(32,000)
Gross profit	22,000	10,000
Distribution costs	(2,000)	(2,000)
Administrative expenses	(6,000)	(3,200)
Finance costs	(300)	(400)
Profit before tax	13,700	4,400
Income tax expense	(4,700)	(1,400)
Profit for the year	9,000	3,000

Statements of financial position as at 31 December 2019

	SM Ltd. Sh."000"	NY Ltd. Sh."000"
Assets:		
Non-current assets		
Property, plant and equipment	40,600	12,600
Current assets	16,000	6,600
Total assets	56,600	19,200
Equity and liabilities:		
Equity shares of Sh.1 each	10,000	4,000
Retained earnings	35,400	6,500
	45,400	10,500
Non-current liabilities:		
10% loan notes	3,000	4,000
Current liabilities	8,200	4,700
Total equity and liabilities	56,600	19,200

Additional information:

1. At the date of acquisition, the fair values of NY Ltd.'s assets were equal to their carrying amounts with the exception of an item of plant, which had a fair value of Sh.2 million in excess of its carrying amount. It had a remaining life of five years at that date (straight line depreciation method is used). NY Ltd. has not adjusted the carrying amount of its plant as a result of the fair value exercise.
2. Sales from NY Ltd. to SM Ltd. in the post-acquisition period amount to Sh.8,000,000. NY Ltd. made a mark-up on cost of 40% on these sales.
   SM Ltd. still had goods worth Sh.2,800,000 (at cost) purchased from NY Ltd. in its inventory as at 31 December 2019.
3. NY Ltd.'s trade receivables as at 31 December 2019 include Sh.600,000 due from SM Ltd. which did not agree with SM Ltd.'s corresponding trade payables. Some of this difference was due to cash in transit of Sh.200,000 from SM Ltd. to NY Ltd. Both companies have positive bank balances.
4. SM Ltd. has a policy of accounting for any non-controlling interest at fair value. For this purpose the fair value of the goodwill attributable to the non-controlling interest in NY Ltd. is Sh.1,500,000. Consolidated goodwill was not impaired as at 31 December 2019.
5. Market price of SM Ltd.'s shares on 1 July 2019 was Sh.6 per share.

Required:

(a) The consolidated income statement for SM Ltd. group for the year ended 31 December 2019. (8 marks)

(b) The consolidated statement of financial position for SM Ltd. group as at 31 December 2019. (12 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Good Ltd. issued a Sh.4 million 7% convertible bond on 1 January 2019 par value. The bond is redeemable at par on 31 December 2023 or can be converted at that date on the basis of two Sh.1 ordinary shares for every Sh.10 of bonds held.

The prevailing market rate at 1 January 2019 for a similar bond without conversion rights was 9% per annum. All interest due in the year to 31 December 2019 has been paid.

Required:

Calculate the amounts to be included in the statement of financial position of Good Ltd. in respect of the convertible bond as at 31 December 2019. (5 marks)

(b) JK Ltd. sponsors a defined benefit pension plan for its members of staff. The corporation's actuary provided the following information about the plan:

	1 January 2019	**31 December 2019**
Defined benefit obligation	Sh.2,500,000	Sh.3,000,000
Plan assets (fair value)	Sh.1,700,000	Sh.2,620,000
Discount rate		10%
Benefits paid in 2019		Sh.200,000
Contribution (funding in 2019)		Sh.700,000
Service costs for the year 2019		Sh.400,000
Pension asset/liability	Sh.800,000	?

Required:

(i) The actual return on the plan assets in 2019. (3 marks)

(ii) The amount of other comprehensive income as of 31 December 2019. (Assume the 1 January 2019 balance was zero). (8 marks)

(iii) Distinguish between "past service costs" and "service costs" in relation to IAS 19 "Employee benefits". (4 marks)

(Total: 20 marks)

....

Present Value Interest factor of 1 Received at the End of *n* Periods at r Percent:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	20%	24%	25%	30%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8333	0.8065	0.8000	0.7692
2	0.9803	0.9612	0.9426	0.9246	0.9070	0.8900	0.8734	0.8573	0.8417	0.8264	0.8116	0.7972	0.7831	0.7695	0.7561	0.7432	0.6944	0.6504	0.6400	0.5917
3	0.9706	0.9423	0.9151	0.8890	0.8638	0.8396	0.8163	0.7938	0.7722	0.7513	0.7312	0.7118	0.6931	0.6750	0.6575	0.6407	0.5787	0.5245	0.5120	0.4552
4	0.9610	0.9238	0.8885	0.8548	0.8227	0.7921	0.7629	0.7350	0.7084	0.6830	0.6587	0.6355	0.6133	0.5921	0.5718	0.5523	0.4823	0.4230	0.4096	0.3501
5	0.9515	0.9057	0.8626	0.8219	0.7835	0.7473	0.7130	0.6806	0.6499	0.6209	0.5935	0.5674	0.5428	0.5194	0.4972	0.4761	0.4019	0.3411	0.3277	0.2693
6	0.9420	0.8880	0.8375	0.7903	0.7462	0.7050	0.6663	0.6302	0.5963	0.5645	0.5346	0.5066	0.4803	0.4556	0.4323	0.4104	0.3349	0.2751	0.2621	0.2072
7	0.9327	0.8706	0.8131	0.7599	0.7107	0.6651	0.6227	0.5835	0.5470	0.5132	0.4817	0.4523	0.4251	0.3996	0.3759	0.3538	0.2791	0.2218	0.2097	0.1594
8	0.9235	0.8535	0.7894	0.7307	0.6768	0.6274	0.5820	0.5403	0.5019	0.4665	0.4339	0.4039	0.3762	0.3506	0.3269	0.3050	0.2326	0.1789	0.1678	0.1226
9	0.9143	0.8368	0.7664	0.7026	0.6446	0.5919	0.5439	0.5002	0.4604	0.4241	0.3909	0.3606	0.3329	0.3075	0.2843	0.2630	0.1938	0.1443	0.1342	0.0943
10	0.9053	0.8203	0.7441	0.6756	0.6139	0.5584	0.5083	0.4632	0.4224	0.3855	0.3522	0.3220	0.2946	0.2697	0.2472	0.2267	0.1615	0.1164	0.1074	0.0725
11	0.8963	0.8043	0.7224	0.6496	0.5847	0.5268	0.4751	0.4289	0.3875	0.3505	0.3173	0.2875	0.2607	0.2366	0.2149	0.1954	0.1346	0.0938	0.0859	0.0558
12	0.8874	0.7885	0.7014	0.6246	0.5568	0.4970	0.4440	0.3971	0.3555	0.3186	0.2858	0.2567	0.2307	0.2076	0.1869	0.1685	0.1122	0.0757	0.0687	0.0429
13	0.8787	0.7730	0.6810	0.6006	0.5303	0.4688	0.4150	0.3677	0.3262	0.2897	0.2575	0.2292	0.2042	0.1821	0.1625	0.1452	0.0935	0.0610	0.0550	0.0330
14	0.8700	0.7579	0.6611	0.5775	0.5051	0.4423	0.3878	0.3405	0.2992	0.2633	0.2320	0.2046	0.1807	0.1597	0.1413	0.1252	0.0779	0.0492	0.0440	0.0254
15	0.8613	0.7430	0.6419	0.5553	0.4810	0.4173	0.3624	0.3152	0.2745	0.2394	0.2090	0.1827	0.1599	0.1401	0.1229	0.1079	0.0649	0.0397	0.0352	0.0195
16	0.8528	0.7284	0.6232	0.5339	0.4581	0.3936	0.3387	0.2919	0.2519	0.2176	0.1883	0.1631	0.1415	0.1229	0.1069	0.0930	0.0541	0.0320	0.0281	0.0150
17	0.8444	0.7142	0.6050	0.5134	0.4363	0.3714	0.3166	0.2703	0.2311	0.1978	0.1696	0.1456	0.1252	0.1078	0.0929	0.0802	0.0451	0.0258	0.0225	0.0116
18	0.8360	0.7002	0.5874	0.4936	0.4155	0.3503	0.2959	0.2502	0.2120	0.1799	0.1528	0.1300	0.1108	0.0946	0.0808	0.0691	0.0376	0.0208	0.0180	0.0089
19	0.8277	0.6864	0.5703	0.4746	0.3957	0.3305	0.2765	0.2317	0.1945	0.1635	0.1377	0.1161	0.0981	0.0829	0.0703	0.0596	0.0313	0.0168	0.0144	0.0068
20	0.8195	0.6730	0.5537	0.4564	0.3769	0.3118	0.2584	0.2145	0.1784	0.1486	0.1240	0.1037	0.0868	0.0728	0.0611	0.0514	0.0261	0.0135	0.0115	0.0053
21	0.8114	0.6598	0.5375	0.4388	0.3589	0.2942	0.2415	0.1987	0.1637	0.1351	0.1117	0.0926	0.0768	0.0638	0.0531	0.0443	0.0217	0.0109	0.0092	0.0040
22	0.8034	0.6468	0.5219	0.4220	0.3418	0.2775	0.2257	0.1839	0.1502	0.1228	0.1007	0.0826	0.0680	0.0560	0.0462	0.0382	0.0181	0.0088	0.0074	0.0031
23	0.7954	0.6342	0.5067	0.4057	0.3256	0.2618	0.2109	0.1703	0.1378	0.1117	0.0907	0.0738	0.0601	0.0491	0.0402	0.0329	0.0151	0.0071	0.0059	0.0024
24	0.7876	0.6217	0.4919	0.3901	0.3101	0.2470	0.1971	0.1577	0.1264	0.1015	0.0817	0.0659	0.0532	0.0431	0.0349	0.0284	0.0126	0.0057	0.0047	0.0018
25	0.7798	0.6095	0.4776	0.3751	0.2953	0.2330	0.1842	0.1460	0.1160	0.0923	0.0736	0.0588	0.0471	0.0378	0.0304	0.0245	0.0105	0.0046	0.0038	0.0014
30	0.7419	0.5521	0.4120	0.3083	0.2314	0.1741	0.1314	0.0994	0.0754	0.0573	0.0437	0.0334	0.0256	0.0196	0.0151	0.0116	0.0042	0.0016	0.0012	*
35	0.7059	0.5000	0.3554	0.2534	0.1813	0.1301	0.0937	0.0676	0.0490	0.0356	0.0259	0.0189	0.0139	0.0102	0.0075	0.0055	0.0017	0.0005	*	*
36	0.6989	0.4902	0.3450	0.2437	0.1727	0.1227	0.0875	0.0626	0.0449	0.0323	0.0234	0.0169	0.0123	0.0089	0.0065	0.0048	0.0014	*	*	*
40	0.6717	0.4529	0.3066	0.2083	0.1420	0.0972	0.0668	0.0460	0.0318	0.0221	0.0154	0.0107	0.0075	0.0053	0.0037	0.0026	0.0007	*	*	*
50	0.6080	0.3715	0.2281	0.1407	0.0872	0.0543	0.0339	0.0213	0.0134	0.0085	0.0054	0.0035	0.0022	0.0014	0.0009	0.0006	*	*	*	*

Present Value Interest factors for Annuity of 1 Discounted at r Percent for *n* Periods:

$$PVIFA_{r,n} = [1 - 1/(1+r)^n]/r$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	20%	24%	25%	30%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8333	0.8065	0.8000	0.7692
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.7125	1.6901	1.6681	1.6467	1.6257	1.6052	1.5278	1.4568	1.4400	1.3609
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4437	2.4018	2.3612	2.3216	2.2832	2.2459	2.1065	1.9813	1.9520	1.8161
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.1024	3.0373	2.9745	2.9137	2.8550	2.7982	2.5887	2.4043	2.3616	2.1662
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6959	3.6048	3.5172	3.4331	3.3522	3.2743	2.9906	2.7454	2.6893	2.4356
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.2305	4.1114	3.9975	3.8887	3.7845	3.6847	3.3255	3.0205	2.9514	2.6427
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.7122	4.5638	4.4226	4.2883	4.1604	4.0386	3.6046	3.2423	3.1611	2.8021
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	5.1461	4.9676	4.7988	4.6389	4.4873	4.3436	3.8372	3.4212	3.3289	2.9247
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.5370	5.3282	5.1317	4.9464	4.7716	4.6065	4.0310	3.5655	3.4631	3.0190
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.8892	5.6502	5.4262	5.2161	5.0188	4.8332	4.1925	3.6819	3.5705	3.0915
11	10.368	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	6.2065	5.9377	5.6869	5.4527	5.2337	5.0286	4.3271	3.7757	3.6564	3.1473
12	11.255	10.575	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.4924	6.1944	5.9176	5.6603	5.4206	5.1971	4.4392	3.8514	3.7251	3.1903
13	12.134	11.348	10.635	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.7499	6.4235	6.1218	5.8424	5.5831	5.3423	4.5327	3.9124	3.7801	3.2233
14	13.004	12.106	11.296	10.563	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.9819	6.6282	6.3025	6.0021	5.7245	5.4675	4.6106	3.9616	3.8241	3.2487
15	13.865	12.849	11.938	11.118	10.380	9.7122	9.1079	8.5595	8.0607	7.6061	7.1909	6.8109	6.4624	6.1422	5.8474	5.5755	4.6755	4.0013	3.8593	3.2682
16	14.718	13.578	12.561	11.652	10.838	10.106	9.4466	8.8514	8.3126	7.8237	7.3792	6.9740	6.6039	6.2651	5.9542	5.6685	4.7296	4.0333	3.8874	3.2832
17	15.562	14.292	13.166	12.166	11.274	10.477	9.7632	9.1216	8.5436	8.0216	7.5488	7.1196	6.7291	6.3729	6.0472	5.7487	4.7746	4.0591	3.9099	3.2948
18	16.398	14.992	13.754	12.659	11.690	10.828	10.059	9.3719	8.7556	8.2014	7.7016	7.2497	6.8399	6.4674	6.1280	5.8178	4.8122	4.0799	3.9279	3.3037
19	17.226	15.678	14.324	13.134	12.085	11.158	10.336	9.6036	8.9501	8.3649	7.8393	7.3658	6.9380	6.5504	6.1982	5.8775	4.8435	4.0967	3.9424	3.3105
20	18.046	16.351	14.877	13.590	12.462	11.470	10.594	9.8181	9.1285	8.5136	7.9633	7.4694	7.0248	6.6231	6.2593	5.9288	4.8696	4.1103	3.9539	3.3158
21	18.857	17.011	15.415	14.029	12.821	11.764	10.836	10.017	9.2922	8.6487	8.0751	7.5620	7.1016	6.6870	6.3125	5.9731	4.8913	4.1212	3.9631	3.3198
22	19.660	17.658	15.937	14.451	13.163	12.042	11.061	10.201	9.4424	8.7715	8.1757	7.6446	7.1695	6.7429	6.3587	6.0113	4.9094	4.1300	3.9705	3.3230
23	20.456	18.292	16.444	14.857	13.489	12.303	11.272	10.371	9.5802	8.8832	8.2664	7.7184	7.2297	6.7921	6.3988	6.0442	4.9245	4.1371	3.9764	3.3254
24	21.243	18.914	16.936	15.247	13.799	12.550	11.469	10.529	9.7066	8.9847	8.3481	7.7843	7.2829	6.8351	6.4338	6.0726	4.9371	4.1428	3.9811	3.3272
25	22.023	19.523	17.413	15.622	14.094	12.783	11.654	10.675	9.8226	9.0770	8.4217	7.8431	7.3300	6.8729	6.4641	6.0971	4.9476	4.1474	3.9849	3.3286
30	25.808	22.396	19.600	17.292	15.372	13.765	12.409	11.258	10.274	9.4269	8.6938	8.0552	7.4957	7.0027	6.5660	6.1772	4.9789	4.1601	3.9950	3.3321
35	29.409	24.999	21.487	18.665	16.374	14.498	12.948	11.655	10.567	9.6442	8.8552	8.1755	7.5856	7.0700	6.6166	6.2153	4.9915	4.1644	3.9984	3.3330
36	30.108	25.489	21.832	18.908	16.547	14.621	13.035	11.717	10.612	9.6765	8.8786	8.1924	7.5979	7.0790	6.6231	6.2201	4.9929	4.1649	3.9987	3.3331
40	32.835	27.355	23.115	19.793	17.159	15.046	13.332	11.925	10.757	9.7791	8.9511	8.2438	7.6344	7.1050	6.6418	6.2335	4.9966	4.1659	3.9995	3.3332
50	39.196	31.424	25.730	21.482	18.256	15.762	13.801	12.233	10.962	9.9148	9.0417	8.3045	7.6752	7.1327	6.6605	6.2463	4.9995	4.1666	3.9999	3.3333

kasneb

CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

WEDNESDAY: 27 November 2019. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) The International Accounting Standards Board's (IASB) framework for the preparation and presentation of financial statements requires financial statements to be prepared on the basis of certain accounting concepts and assumptions:

Required:
Explain the following concepts and assumptions:

(i) Accruals concept. (1 mark)

(ii) Substance over form. (1 mark)

(iii) Prudence. (1 mark)

(iv) Comparability. (1 mark)

(v) Materiality. (1 mark)

(b) The following financial statements were extracted from the books of Ujenzi Ltd.:

Statement of comprehensive income for the year ended 30 June 2019:

	Sh. "000"
Revenue	8,600
Cost of sales	(4,000)
Gross profit	4,600
Operating expenses	(2,000)
Finance costs	(500)
Profit before tax	2,100
Income tax expenses	(900)
Profit after tax	1,200
Dividend paid in the year	600
Retained earnings	600

Statement of financial position as at 30 June:

	2019		2018	
	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"
Non-current assets:				
Property, plant and equipment		8,400		7,400
Current assets:				
Inventory	3,000		3,200	
Trade receivables	4,400	7,400	3,600	6,800
Total assets		15,800		14,200

	2019		2018	
	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"
Equity and liabilities:				
Equity				
Ordinary share capital		2,400		2,400
Retained earnings		4,400		3,800
		6,800		6,200
Non-current liabilities:				
Deferred tax	2,140		1,700	
Finance lease liabilities	2,600	4,740	2,400	4,100
Current liabilities:				
Trade payables	2,500		2,180	
Current tax	450		410	
Finance lease liabilities	1,000		900	
Bank overdrafts	310	4,260	410	3,900
		15,800		14,200

Additional information:

1. Depreciation charged for the year ended 30 June 2019 amounted to Sh.1,940,000.
2. During the year ended 30 June 2019, there was no disposal of property, plant or equipment.
3. There was no accrual of interest at the beginning or at the end of the year.
4. Ujenzi Ltd. finances some of its property, plant and equipment using finance leases. During the year ended 30 June 2019, property, plant and equipment which could have cost Sh.1,200,000 to purchase were acquired under finance lease.

Required:

(i) Statement of cash flows in accordance with the requirements of the International Accounting Standard (IAS) 7, "Statement of Cash Flows". (10 marks)

(ii) Summarise five advantages of cash flow statements to the users of financial statements. (5 marks)

(Total: 20 marks)

QUESTION TWO

(a) Financial statements analysis might be a useful tool for understanding a firm's performance.

In relation to the above statement, discuss five challenges that a financial analyst might face while analysing financial statements. (10 marks)

(b) The following information relates to Red Ltd. for the year ended 30 June 2019:

	Sh.
Long-term debt:	
10% notes payable	1,000,000
8% convertible bonds payable	5,000,000
10% bonds payable	6,000,000
Total long-term debt	12,000,000
Shareholders equity:	
6% cumulative preference shares (Sh.50 par value): 100,000 shares authorised, 25,000 shares issued and outstanding	1,250,000
Ordinary shares (Sh.1 par value): 10,000,000 shares authorised 1,000,000 shares issued and outstanding	1,000,000
Additional paid in capital	4,000,000
Retained earnings	6,000,000
Total shareholders equity	12,250,000

Additional information:

1. Options were granted on 1 July 2018 to purchase 200,000 shares at Sh.15 per share. Although no options were exercised during the year ended 30 June 2019, the average price per ordinary share was Sh.20.
2. Each bond was issued at face value. The 8% convertible bonds will convert into ordinary shares at 50 shares per Sh.1,000 bonds. The bonds are exercisable after 5 years and were issued in the year ended 30 June 2018.
3. The preference shares were issued during the year ended 30 June 2018.
4. There are no preference share dividends in arrears. However, preference share dividends were not declared in the year ended 30 June 2019.
5. The 1,000,000 ordinary shares were outstanding for the entire year ended 30 June 2019.
6. Net income for the year ended 30 June 2019 was Sh.1,500,000 and the average income tax rate is 30%.

Required:

(i) Basic earnings per share (BEPS) for the year ended 30 June 2019. (3 marks)

(ii) Diluted earnings per share (DEPS) for the year ended 30 June 2019. (7 marks)

(Total: 20 marks)

QUESTION THREE

Bidii Ltd. has identified Sweet Ltd. as a possible acquisition. Sweet Ltd. is currently owned by Yummy Ltd.

The following are extracts from the financial statements of Sweet Ltd.

Extract from the income statement for the year ended 31 December 2018:

	Sh."000"
Revenue	54,200
Cost of sales	(21,500)
Gross profit	32,700
Operating expenses	(11,700)
Operating profit	21,000

Statement of financial position as at 31 December 2018:

	Sh."000"	Sh."000"
Assets		
Non-current assets		24,400
Current assets:		
Inventory	4,900	
Receivables	5,700	
Cash at bank	2,300	12,900
Total assets		37,300
Equity and liabilities:		
Equity		
Equity shares		1,000
Retained earnings		8,000
		9,000
Liabilities		
Non-current liability		
Loan		16,700
Current liabilities:		
Trade payables	5,400	
Current tax payables	6,200	11,600
Total equity and liabilities		37,300

Additional information:

1. On 1 April 2018, Sweet Ltd. decided to focus on its core business and so disposed of a non-core division. The disposal generated a loss of Sh.1.5 million which included operating expenses.

   The following extracts show the results of the non-core division for the period prior to disposal which were included in Sweet Ltd.'s results for 2018:

	Sh. "000"
Revenue	2,100
Cost of sales	(1,200)
Gross profit	900
Operating expenses	(700)
Operating profit	200

2. Sweet Ltd. pays a management charge of 1% of revenue to Yummy Ltd. which is included in its operating expenses. Bidii Ltd. imposes a management charge of 10% of gross profit on all of its subsidiaries.
3. Sweet Ltd.'s administrative offices are currently located within a building owned by Yummy Ltd. If Sweet Ltd. were acquired, the company would need to seek alternative premises. Sweet Ltd. paid rent of Sh.46,000 in 2018. Commercial rent for equivalent office space would cost Sh.120,000.

Required:

(a) Sweet Ltd.'s income statement for the year ended 31 December 2018 to adjust for the disposal of the non-core division, management charge and rent charges which would be imposed assuming Sweet Ltd. was acquired by Bidii Ltd. (5 marks)

(b) Calculate the following ratios for the year ended 31 December 2018 based on the restated financial information in (a) above:

Note: You should assume that any increase or decrease in profit as a result of your adjustment will also increase or decrease cash:

(i) Gross profit margin. (1 mark)

(ii) Operating profit margin. (1 mark)

(iii) Receivables collection period. (1 mark)

(iv) Acid-test ratio. (1 mark)

(v) Gearing (debt/equity) (1 mark)

(c) The following information relates to Kikombe Ltd:

Year	**2014**	**2015**	**2016**	**2017**	**2018**
Profit margin (%)	11.4	12.3	13.5	15.5	16.7
Retention ratio (%)	91.3	91.9	92.8	92.2	86.6
Asset turnover	1.25	1.14	1.11	1.00	0.97
Assets (Sh.)	2,436	3,118	3,861	4,923	5,483
Equity (Sh.)	1,406	1,756	2,233	2,958	3,219
Growth rate in sales (%)	17.8	16.4	21.4	14.0	8.5

Required:

(i) The firm's annual sustainable growth rate from year 2014 to year 2018. (4 marks)

(ii) Explain how the firm copes with its sustainable growth problems. (1 mark)

(d) Bahari Equipments Ltd. sells high quality lawn mowers and offers a three year warranty on all new lawn mowers sold. During the year 2018, the firm sold new speciality mowers for Sh.300,000.

Bahari's service department does not have the equipment to service the new lawn mowers and therefore has entered into an agreement with Top Mower Ltd. to provide all warranty service on the special mowers sold in the year 2018.

Bahari Equipments Ltd. wishes to measure the fair value of the agreement in order to determine the warranty liability for sales made during the year 2018.

The financial analyst for Bahari Equipments Ltd. estimates the following expected warranty cash flows associated with the mowers sold during the year 2018:

Year	Cash flow estimate (Sh.)	Probability assessment (%)
2019	2,500	20
	4,000	60
	5,000	20
2020	3,000	30
	5,000	50
	6,000	20
2021	4,000	30
	6,000	40
	7,000	30

All cash flows occur at the end of the year. The annual discount rate is 5%.

Required:
The value of the warranty liability for year 2018 sales. (5 marks)
(Total: 20 marks)

QUESTION FOUR

(a) Preparations of group accounts is considered necessary. However, group accounts might be misleading.

With reference to the above statement, outline three limitations of group accounts. (3 marks)

(b) The statements of financial position for JDR Ltd. and BZ Ltd. as at 30 June 2019 are provided below:

	JDR Ltd. Sh."000"	BZ Ltd. Sh."000"
Assets		
Non-current assets:		
Property, plant and equipment	80,650	17,000
Available for sale investment	14,350	-
	95,000	17,000
Current assets:		
Inventory	18,000	4,000
Receivables	30,000	9,500
Cash and cash equivalents	6,000	1,500
Total assets	149,000	32,000
Equity and liabilities:		
Equity		
Share capital (Sh.1 equity shares)	50,000	5,000
Retained earnings	68,000	13,000
Other reserves	800	-
Total equity	118,800	18,000
Non-current liabilities	10,000	4,000
Current liabilities	20,200	10,000
Total equity and liabilities	149,000	32,000

Additional information:

1. JDR Ltd. acquired a 20% investment in BZ Ltd. on 1 February 2015 for Sh.3,200,000. The investment was classified as available for sale with any associated gains or losses recorded within other reserves in JDR Ltd.'s individual financial statements.
2. On 1 January 2019, JDR Ltd. acquired an additional 60% of the equity share capital of BZ Ltd. at a cost of Sh.10,350,000 when the retained earnings of BZ Ltd. were Sh.10,500,000.
3. The fair value of the original 20% investment at 1 January 2019 was Sh.3,950,000. In its own financial statements, JDR Ltd. continues to hold the investment in BZ Ltd. as an available for sale asset and it is recorded at its fair value of Sh.14,350,000 as at 30 June 2019.
4. As at 1 January 2019, the fair value of the net assets of BZ Ltd. was assessed to be the same as its carrying value with one exception, property, plant and equipment (PPE).
5. Leasehold property with a carrying value of Sh.6,400,000 had a fair value of Sh.8,000,000. The remaining useful life of this asset is 10 years from the date of acquisition.
6. Depreciation on property, plant and equipment is charged on a monthly straight line basis. The fair value of plant and equipment was declared to be equivalent to its carrying value at the date of acquisition.
7. It is the group policy to value non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interest at 1 January 2019 was Sh.3,700,000.
8. BZ Ltd. receivables as at 30 June 2019 included Sh.3,000,000 in respect of goods sold by BZ Ltd. to JDR Ltd. in April 2019. JDR Ltd.'s inventories as at 30 June 2019 included Sh.1,000,000 of these goods and closing payables included an amount due to BZ Ltd. of Sh.1,000,000.
9. JDR Ltd. made a payment of Sh.2,000,000 to BZ Ltd. on 30 June 2019.
10. BZ Ltd. makes a margin of 20% on all sales.

Required:

The consolidated statement of financial position as at 30 June 2019 for the JDR Ltd. group. (17 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Accounting for retirement benefits remains one of the most challenging areas in financial statements analysis.

With reference to the above statement, discuss four key issues in the determination of the method of accounting for retirement benefits in respect of defined benefit plans. (8 marks)

(b) Ndoto Ltd. provides post-employment benefits to its employees through a defined benefit plan.

The following data relates to the plan as at 30 June:

	2019 Sh."000"	2018 Sh."000"
Present value of obligation at year end	72,000	66,000
Fair value of plan assets at year end	62,000	60,000
Current service cost	12,000	11,400
Benefits paid by plan	16,000	15,000
Contribution paid into plan	11,600	11,200
Discount rate at the start of the year	10%	9%
Expected rate of return on plan assets at the start of the year	7%	6%
Average remaining service life of participating employees	20 years	20 years

Additional information:

1. On 1 July 2018, Ndoto Ltd. had net unrecognised actuarial losses of Sh.8.4 million.
2. Ndoto Ltd. accounts for actuarial gains and losses using the corridor method.

Required:

(i) Extract of income statement for the year ended 30 June 2019. (3 marks)

(ii) Extract of the statement of financial position as at 30 June 2019. (3 marks)

(iii) The changes in the present value of the defined benefit obligation. (3 marks)

(iv) The changes in the fair value of the plan assets. (3 marks)

(Total: 20 marks)

....

Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8065	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	.5739	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	.5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5674	.4936	.4155	.3503	.2959	2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0318	.0221	.0107	.0053	0037	.0026	.0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1-\frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 23 May 2019. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Describe the steps followed by financial analysts while undertaking a financial statements analysis assignment. (4 marks)

(b) (i) Explain the term "macro environment approach" to financial statements analysis. (1 mark)

(ii) Citing relevant examples, outline three factors that forms the basis of macro-economic environment of a firm. (3 marks)

(c) Pipel Limited, a public listed company carries out business in airline technology. It has made several investments, operating in diversified businesses. The following statements of comprehensive income relate to Pipel Limited and its investment companies for the year ended 30 April 2019:

	Pipel Limited Sh."million"	**Sial Limited Sh."million"**	**Abbel Limited Sh."million"**
Revenue	2,060	590	360
Cost of sales	(1,050)	(220)	(270)
Gross profit	1,010	370	90
Selling and distribution costs	(245)	(77)	(68)
Administrative expenses	(315)	(99)	(112)
Operating profits (or loss)	450	194	(90)
Finance costs	(140)	(44)	-
Profit (or loss) before tax	310	150	(90)
Income tax expense (credit)	(75)	(50)	10
Profit (or loss) for the year	235	100	(80)
Other comprehensive income – Revaluation gain	50	25	10
Total comprehensive income	285	125	(70)

Additional information:

1. Pipel Limited has owned 80% of the equity interest in Sial Limited for several years.
2. On 1 May 2014, Pipel Limited acquired 60% of the equity shares of Abbel Limited. The purchase consideration comprised cash of Sh.645 million and the fair value of the identifiable net assets acquired was Sh.775 million at that date.
3. Pipel Limited wishes to use the "partial goodwill" method for all acquisitions. There has been no impairment of goodwill in either Sial Limited or Abbel Limited since acquisition.
4. Pipel Limited disposed of a 20% equity interest in Abbel Limited on 31 October 2018 for Sh.280 million. At that date, Abbel Limited's identifiable net assets were Sh.955 million. The remaining equity interest in Abbel Limited was fair valued at Sh.560 million.
5. During the year ended 30 April 2019, Sial Limited sold goods worth Sh.60 million to Pipel Limited. Sial Limited makes all sales at a profit mark-up of $33\frac{1}{3}\%$ above the cost. Pipel Limited still had one third of these goods in its inventory on 30 April 2019.
6. Assume profit (or loss) and revaluation gain accrued evenly over the year.

Required:

(i) The profit or loss on disposal of shares in Abbel Limited to be presented on the group statement of comprehensive income. (4 marks)

(ii) Consolidated statement of comprehensive income for Pipel Group for the year ended 30 April 2019. (8 marks)

(Total: 20 marks)

QUESTION TWO

(a) Financial statements are highly aggregated which could make them of limited use for stakeholders who want to understand more about how an entity has arrived at its financial performance and position for a period.

In order to allow stakeholders to fully understand the development of the company's business, International Financial Reporting Standard (IFRS) 8 "operating segments", requires certain entities to provide segmental analysis of information which discloses revenues, profits and assets by major business area.

IFRS 8 is only compulsory for entities whose debt or equity instruments are traded in a public market or entities filing or in the process of preparing financial statements for the purpose of getting listed.

Required:
With reference to International Financial Reporting Standard (IFRS) 8 "operating segments", highlight six key disclosures required for the discrete financial information. (6 marks)

(b) Babito Limited, a public limited company has a called up and paid up capital comprising of 2 million ordinary shares of Sh.10 each and 400,000, 8% redeemable preference shares of Sh.15 each on 1 January 2018.

The company had also in issue Sh.5 million, 10% convertible bond, to be converted at any time at the holders' option into 15 ordinary shares of Sh.10 each for every Sh.100 of the bond.

The following transactions took place during the year ended 31 December 2018:

1. During the year, the group reported profit after tax of Sh.3,480,000 which included a loss after tax from discontinued operations of Sh.420,000.
2. On 1 April 2018, Babito Limited made a one for every four rights issue of ordinary shares to the existing shareholders at a concessionary price of Sh.36 per right. The market price of the company's share on the last day quotation on cumrights price basis was Sh.41.
3. On 1 August 2018, the company issued 1.2 million ordinary shares for a full market price as a consideration for the acquisition of an overseas property.
4. On 1 October 2018, holders of Sh.2 million, 10% convertible bond exercised their conversion option and were issued with ordinary shares at that date.

The corporation tax rate is at 30%.

Required:

(i) Basic earnings per share (BEPS) for the year ended 31 December 2018. (4 marks)

(ii) Diluted earnings per share (DEPS) for the year ended 31 December 2018. (4 marks)

(c) John Mundia, a financial analyst at Beta Capital has been provided with the following results for Panrama Limited for the year ended 31 December 2018:

Net profit margin ratio	0.04
Total asset turnover ratio	2.20
Total assets/equity ratio	2.40
Earnings per share (Sh.)	2.75
Dividends per share (Sh.)	1.25

Required:
The estimated growth rate for the company. (2 marks)

(d) Maria and Lynette are discussing accounting for income taxes. They are currently studying a schedule of taxable and deductible amounts that will arise in the future as a result of existing temporary differences. The schedule is as follows:

		Future years			
	2018	**2019**	**2020**	**2021**	**2022**
Taxable income (Sh.)	850,000				
Taxable amounts (Sh.)		375,000	375,000	375,000	375,000
Deductible amounts				(2,400,000)	
Enacted tax rate	30%	32%	33%	30%	25%

Required:
Explain the concept of future taxable amounts and future deductible amounts as illustrated in the above schedule. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) A company's financial statements are the most objective way to assess the health of an organisation. As the old adage says "numbers don't lie". Numbers can indicate prosperity or poverty, but they can also show the first signs of trouble within a company.

In relation the above statement, summarise six red flags that could indicate trouble for a business. (6 marks)

(b) The following are the extracts from the statements of financial position for Global Manufacturing Corporation for the years ended 31 December 2017 and 31 December 2018:

Statement of financial position as at 31 December:

	2018 Sh."000"	2017 Sh."000"
Assets:		
Current assets:		
Cash	73,000	22,000
Accounts receivable	82,000	66,000
Inventory	180,000	189,000
	335,000	277,000
Non-current assets:		
Land and buildings	71,000	110,000
Equipment	260,000	200,000
Accumulated depreciation - equipment	(69,000)	(42,000)
	262,000	268,000
Total assets	597,000	545,000
Liabilities and shareholder's equity:		
Accounts payable	34,000	47,000
Bonds payable	150,000	200,000
Ordinary shares (Sh.1 par value)	214,000	164,000
Retained earnings	199,000	134,000
Total liabilities and shareholders equity	597,000	545,000

Additional information:

1. Net income for 2018 was Sh.125,000,000. No gains and losses were recorded in the year 2018.
2. Cash dividends amounting to Sh.60,000,000 was declared and paid.
3. Bonds payable amounting to Sh.50,000,000 were retired through issuance of ordinary shares.

Required:

(i) Statement of cash flows in accordance with the requirements of the International Accounting Standard (IAS) 7, "Statements of Cash Flows". (7 marks)

(ii) Current cash debt coverage ratio. (2 marks)

(iii) Cash debt coverage ratio. (2 marks)

(iv) Free Cash Flow (FCF). (2 marks)

(v) Comment on the firm's liquidity and financial flexibility based on your results obtained in (b) (i) to (b) (iv) above. (1 mark)

(Total: 20 marks)

QUESTION FOUR

(a) A foreign subsidiary was created on 31 December 2017. The LC is the currency of the country in which the foreign subsidiary is located. The subsidiary's statement of financial position as at 31 December 2017 and 31 December 2018 and income statement for the year ended 31 December 2018 are shown below:

Statement of financial position as at 31 December:

	2017 (LC)	2018 (LC)
Cash	5,000	8,000
Inventory	25,000	25,000
Total assets	30,000	33,000

	2017 (LC)	2018 (LC)
Equity and liabilities:		
Accounts payable	20,000	20,000
Ordinary shares	10,000	10,000
Retained earnings	-	3,000
Total equity and liabilities	30,000	33,000

Income statement for the year ended 31 December 2018:

Revenue	15,000
Expenses	(12,000)
Net income	3,000

The following price indices are available:

31 December 2017	100
31 December 2018	150
Average for 2018	125

Required:
Prepare an inflation adjusted:

(i) Statement of financial position as at 31 December 2018. (4 marks)

(ii) Income statement for the year ended 31 December 2018. (3 marks)

(b) Sunny Limited issued a redeemable debt instrument on 1 July 2017 at its par value of Sh.6 million. The instrument carries a fixed coupon interest rate of 6% which is payable annually in arrears. The debt instrument will be redeemed for Sh.6.02 million on 30 June 2021. Transaction costs associated with the issue were Sh.200,000 and were paid at the time of issue. The effective interest rate applicable to this liability is approximately 7.06%.

Required:

(i) Explain how this instrument will be initially measured and subsequently measured. (2 marks)

(ii) Calculate the carrying value of this liability to be included in Sunny Limited's statement of financial position as at 30 June 2019. (Round all workings to the nearest thousand). (4 marks)

(c) Triple D Limited operates a defined benefit pension plan for its employees. At 1 July 2017, the fair value of the pension plan assets was Sh.1,200,000 and the present value of the plan liabilities was Sh.1,400,000. The interest cost on the plan liabilities was estimated at 7% and the expected return on plan assets was estimated at 4%.

The actuary estimates that the current service cost for the year ended 30 June 2018 shall be Sh.300,000. Triple D Limited made contributions into the pension plan of Sh.400,000 in the year ended 30 June 2018. The pension plan paid Sh.220,000 to retired members in the year to 30 June 2018. At 30 June 2018, the fair value of the pension plan assets was Sh.1,400,000 and the present value of the plan liabilities was Sh.1,600,000.

In accordance with International Accounting Standard (IAS) 19, "Employee Benefits", Triple D Limited recognises actuarial gain and losses in other comprehensive income in the period in which they occur.

Required:

(i) The net expense that will be included in Triple D Limited's income statement for the year ended 30 June 2018. (2 marks)

(ii) The amounts that would be included in other comprehensive income in respect of actuarial gains or losses for the year ended 30 June 2018. (5 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following information was extracted from the financial records of TBT Limited, a business which provides technical support services to customers worldwide:

Extracts of income statement for the years ended 31 March:

	2019 Sh."million"	2018 Sh."million"
Sales revenue	3,627	3,908
Cost of sales	(2,765)	(2,886)
Gross profit	862	1,022

Extracts of statement of financial position as at 31 March:

	2019 Sh."million"	2018 Sh."million"
Current assets:		
Inventories	271	330
Trade receivables	632	719
Short-term deposits and cash	342	242
	1,245	1,291
Current liabilities:		
Loans and overdrafts	54	135
Tax payable	113	128
Accruals	20	29
Trade payables	512	479
	699	771

Required:

(i) Horizontal analysis for income statement for the year ended 31 March 2019. (2 marks)

(ii) Horizontal analysis for the statements of financial position as at 31 March 2019. (4 marks)

(iii) Current ratios for the financial years 2018 and 2019. (2 marks)

(iv) Quick ratio for the financial years 2018 and 2019. (2 marks)

(b) The following is a draft statement of financial position of Mawingu Limited as at 31 December 2018:

Statement of financial position as at 31 December 2018:

	Sh."000"
Assets:	
Non-Current assets:	
Property, plant and equipment (net)	20,000
Intangible assets	4,000
	24,000
Current assets:	
Cash	1,000
Marketable securities	500
Accounts receivable	5,000
Inventories	3,500
	10,000
Total assets	34,000
Equity and liabilities:	
Current liabilities:	
Accounts payable	3,000
Notes payable	2,000
Total current liabilities	5,000
Non-current liabilities:	
Long-term debt	10,000
Ordinary shares (1,000,000 shares)	7,000
Retained earnings	12,000
	29,000
Total equity and liabilities	34,000

Additional information:

1. Inventories are valued at cost as determined using Last in first out (LIFO) method. The LIFO reserve is Sh.500,000.
2. Additional operating facilities and equipment are financed with operating leases that have a present value of Sh.5,000,000.
3. Intangible assets represent Sh.4,000,000 of goodwill from previous acquisitions.
4. Due to an increase in interest rates, Mawingu Limited's long-term debt has a current market value of Sh.9,500,000.

Required:

(i) Adjusted statement of financial position as at 31 December 2018. (6 marks)

(ii) Book value per share before and after adjustment. (2 marks)

(iii) Ratio of long-term debt to equity before and after adjustment. (2 marks)

(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 29 November 2018. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) According to International Accounting Standard (IAS) 32:, "Financial Instruments: Presentation", the issuer of a financial instrument must classify it as either a financial liability or equity instrument on initial recognition according to its substance.

Required:
With reference to the above statement, describe the accounting treatment of a compound instrument on initial recognition and on subsequent measurement. (8 marks)

(b) Godin Limited is a public limited company with a portfolio of investments in many other entities. The extracts from its most recent financial statements are as set out below:

Income statement for the year ended 31 October:

	2018	2017
	Sh."000"	Sh."000"
Revenue	126,000	175,000
Cost of sales	(84,000)	(105,000)
Gross profit	42,000	70,000
Profit on disposal of a subsidiary	3,500	-
Distribution costs	(12,250)	(18,550)
Administrative expenses	(16,800)	(10,150)
Finance costs	(1,400)	(2,800)
Profit before tax	15,050	38,500
Income tax expense	(4,550)	(11,550)
Profit for the year	10,500	26,950

Statement of financial position as at 31 October:

	2018	2017
Non-Current assets:	Sh."000"	Sh."000"
Property, plant and equipment	57,050	66,500
Intangible asset - goodwill	-	7,000
	57,050	73,500
Current assets:		
Inventories	11,900	20,300
Trade receivables	4,550	8,400
Cash and cash equivalents	5,250	-
	21,700	28,700
Total assets	78,750	102,200
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.10 each	35,000	35,000
Retained earnings	10,500	14,000
	45,500	49,000
Non-current liabilities:		
10% debentures	14,000	28,000
Current liabilities:		
Bank overdraft	-	4,900
Trade and other payables	15,050	10,850
Current tax payable	4,200	9,450
	19,250	25,200
Total equity and liabilities	78,750	102,200

Additional information:

1. On 1 November 2017, Godin Limited sold the net assets (including goodwill) of a 100% owned subsidiary for Sh.28 million cash on which it reported a gain of Sh.3.5 million. This disposal required approval by the shareholders of the parent entity. In order to achieve this, the directors of Godin Limited offered the shareholders a dividend of Sh.1.40 for each share in issue out of these disposal proceeds.

   The trading results of the discontinued subsidiary indicated above, which are included in the income statement for the year ended 31 October 2017 were:

	Sh."000"
Revenue	63,000
Cost of sales	(35,000)
Gross profit	28,000
Distribution costs	(3,500)
Administrative expenses	(4,200)
Profit before interest and tax	20,300

2. The following selected ratios for Godin Limited have been calculated for the year ended 31 October 2017:

Gross profit margin	40%
Return on capital employed	53.6%
Operating profit margin	23.6%
Net assets turnover	2.27 times

Required:

Compute the equivalent ratios for Godin group for the year ended:

(i) 31 October 2017 after excluding the consideration/contribution made by the disposal of the subsidiary. (4 marks)

(ii) 31 October 2018, excluding the gain on disposal of the subsidiary. (4 marks)

(iii) Based on the computed ratios in (b) (i) and (b) (ii) above, assess the comparative financial performance and financial position of Godin group as at 31 October 2018. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) Differentiate between the "auditor's report" and the "management commentary". (4 marks)

(b) ABC Company is evaluating a lease arrangement being offered by TKM Company for use of a computer system. The lease is non-cancellable and in no case will ABC Company receive title to the computer system during or at the end of the lease term. The lease starts on 1 January 2018, with the first rental payment due on 1 January 2018.

Additional information relating to the lease is as follows:

Yearly rental payments	Sh.3,557.25 million.
Lease term	3 years.
Estimated economic life	5 years.
Purchase option	Sh.3,000 million at the end of 3 years, which approximates fair value.
Renewal option	1 year at Sh.1,500 million, no penalty for non-renewal as per standard renewal clause.
Fair value at inception of lease	Sh.10,000 million.
Cost of asset to lessor	Sh.10,000 million.
Residual value:	
Guaranteed	Nil.
Unguaranteed	Sh.3,000 million.
Lessor's implicit rate (known by the lessee)	12%.
Executory costs paid by lessor	Sh.500 million per year and is included in the yearly rental payments.
Estimated fair value at the end of lease	Sh.3,000 million.

Required:

Analyse the lease capitalisation criteria for this lease for ABC Company. (6 marks)

(c) Omondi Enterprises Ltd., designs and manufactures locally made suits and the company's primary market is abroad. Sales have increased drastically in recent years. Such drastic growth has significant implications for cash flows. Provided below are the cash flow statements for the company for two recent years:

	Current year Sh.	Prior year Sh.
Cash flows from operating activities:		
Net income	17,523	838,955
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	(69,524)	(146,590)
Depreciation and amortisation	316,416	181,348
Changes in assets and liabilities:		
Accounts receivable	(38,267)	(25,947)
Inventories	(1,599,014)	(1,289,293)
Prepayments and other current assets	(444,794)	(113,205)
Deposits and other assets	(24,240)	(83,044)
Accounts payable	2,017,059	(284,567)
Accrued expenses	61,321	170,755
Accrued interest payable (debentures)	-	(67,179)
Income taxes payable	-	117,810
Net cash used for operating activities	236,480	(700,957)
Net cash used for investing activities	(2,102,892)	(4,422,953)
Net cash used for financing activities	(315,353)	9,685,435
Net change in cash and cash equivalents	(2,181,765)	4,561,525
Other information:		
Current liabilities	4,055,465	1,995,600
Total liabilities	4,620,085	2,184,386
Net sales	20,560,566	17,025,856

Required:

(i) Noting that net income in the current year was only Sh.17,523 compared to prior year net income of Sh.838,955, but net cash flow from operating activities was Sh.236,480 in the current year and a negative Sh.700,957 in the prior year;

Explain the causes of this apparent paradox. (4 marks)

(ii) Evaluate the firm's liquidity, solvency and profitability for the current year using cash flow based ratios. (6 marks)

(Total: 20 marks)

QUESTION THREE

(a) Entities have a choice of the accounting policy they may wish to use in the preparation of financial statements. However, the financial results of an entity could be altered significantly by the choice of the accounting policy.

Required:

With reference to the above statement, identify three key limitations of ratio analysis. (6 marks)

(b) The following information was extracted from the financial records of Mickeyland Limited:

	Sh."000"
Revenue	1,857,000
Profit before interest and tax	298,500
Interest on loan	16,500
Income tax expense	69,000
Total assets	2,595,000
Shareholders' equity	1,506,000
Loan capital	243,000

Required:

The company's return on equity (ROE) using the three-step DuPont analysis. (4 marks)

(c) Wingstone Limited bought a drilling machine for Sh.7.2 million on 1 April 2016. The machine had an estimated economic useful life of six years on that date and a straight line depreciation to a nil residual value was provided.

On 1 April 2017, Wingstone Limited sold the machine to Whitesands Limited for Sh.8,880,000 at its fair value.

Wingstone Limited immediately leased the machine back from Whitesands Ltd. for five years (the remainder of its useful life) at a rental of Sh.1,920,000 per annum payable in arrears. The present value of the annual lease payments at the inception of the leaseback amounted to Sh.8.4 million at an implicit interest rate of 4.625%.

The transaction satisfies the International Financial Reporting Standard (IFRS) 15: Revenue from Contracts with Customers.

Required:

(i) The amount of the gain that Wingstone Limited should recognise for the year ended 31 March 2018 in respect of the sale and leaseback. (4 marks)

(ii) The extracts of financial statements of Wingstone Limited for the year ended 31 March 2018 to account for the right-of-use asset and lease liability. (6 marks)

(Total: 20 marks)

QUESTION FOUR

(a) In relation to stock compensation plan, discuss three advantages of restricted stock plans. (6 marks)

(b) On 1 June 2015, Juhudi Ltd. and Jamii Ltd. merged to form Jumii Ltd. A total of 800,000 shares were issued to complete the merger.

On 1 April 2017, the new corporation issued an additional 400,000 shares of stock and cash. All 1,200,000 shares were outstanding on 31 December 2017. Jumii Ltd. also issued Sh.600,000 of 20 year, 8% convertible bonds at par on 1 July 2017. Each Sh.1,000 bond converts to 40 ordinary shares at any interest date. None of the bonds have been converted to date. For the year ended 31 December 2017, the annual report indicated that the company had an after-tax net income of Sh.1,540,000. The tax rate is 30%.

Required:

The firm's diluted earnings per share (EPS). (8 marks)

(c) The following are the comparative income and retained earnings statements, for Pingu Ltd. for the years 2016 and 2017:

	2017	**2016**
	Sh.	**Sh.**
Sales	340,000	270,000
Cost of sales	(200,000)	(142,000)
Gross profit	140,000	128,000
Expenses	(88,000)	(50,000)
	52,000	78,000
Retained earnings (1 January)	125,000	72,000
Net income	52,000	78,000
Dividends	(30,000)	(25,000)
Retained earnings (31 December)	147,000	125,000

Additional information:

1. In the year 2017, Pingu Ltd. decided to switch its depreciation method from sum-of-the years' digits to the straight-line method.

   The assets were purchased at the beginning of year 2016 for Sh.100,000 with an estimated useful life of 4 years and no salvage value. The year 2017 income statement contains depreciation expense of Sh.30,000 on the assets purchased at the beginning of year 2016.
2. In the year 2017, Pingu Ltd. discovered that the ending inventory for the year 2016 was overstated by Sh.24,000.
3. The ending inventory for the year 2017 was correctly stated.

Required:

The revised earnings statement for the years 2016 and 2017. (Ignore income taxes). (6 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain the term "earnings quality" in relation to accrual component of earnings and earnings management. (2 marks)

(b) On 1 October 2016, HM Ltd. acquired 2,000,000 ordinary shares of SJ Ltd. by paying Sh.4.50 per share. As at the date of acquisition, the retained earnings of SJ Ltd. were Sh.4,200,000.

The draft statements of financial position of the two companies as at 30 September 2018 were as follows:

	HM Ltd. Sh."000"	SJ Ltd. Sh."000"
Assets:		
Non-current assets:		
Land	11,000	6,000
Plant and equipment	10,225	5,110
Investment in SJ Ltd.	9,000	-
	30,225	11,110
Current assets:		
Inventories	4,925	3,295
Trade receivables	5,710	1,915
Cash	495	-
	11,130	5,210
Total assets	41,355	16,320
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.1 each	5,000	2,500
Retained earnings	25,920	8,290
	30,920	10,790
Non-current liabilities:		
10% loans	6,000	2,000
Current liabilities:		
Trade payables	3,200	2,255
Bank overdraft	-	285
Corporation tax	1,235	990
	4,435	3,530
Total equity and liabilities	41,355	16,320

Additional information:

1. Extracts from the income statement of SJ Ltd. before inter-group adjustments for the year ended 30 September 2018 are as follows:

	Sh."000"
Profit before tax	2,700
Corporation tax	(800)
Profit after tax	1,900

2. During the year, SJ Ltd. sold goods to HM Ltd. for Sh.900,000. SJ Ltd. adds a 20% mark-up on cost to all its sales. Goods with a transfer price of Sh.240,000 were included in HM Ltd.'s inventories as at 30 September 2018.
3. The fair value of SJ Ltd.'s land, plant and equipment at the date of acquisition was Sh.1,000,000 and Sh.2,000,000 respectively in excess of the carrying values. SJ Ltd.'s statement of financial position has not taken account of these fair values. The group depreciation policy is that land should not be depreciated while plant and equipment should be depreciated at the rate of 10% per annum on fair value.
4. During the year, an impairment review was carried out on the consolidated goodwill and it was found that the goodwill had been impaired by Sh.400,000 as at 30 September 2018.

Required:

(i) Determine the value of goodwill arising on acquisition of SJ Ltd. (5 marks)

(ii) HM Ltd. group consolidated statement of financial position as at 30 September 2018. (13 marks)

(Total: 20 marks)

....

Present Value of 1 Received at the End of n Periods:

$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8065	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	.5739	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6499	.6209	.5674	.5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665	.4039	.3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241	.3606	.3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	.1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	.0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0596	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486	.1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	.0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0318	.0221	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1 - \frac{1}{(1+r)^t}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2.5342
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2.9304
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2.9776
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3.0609
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3.0764
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3.1129
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3.1220
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3.1242
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791	8.2438	7.1050	6.6418	6.2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3.1250
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3.1250

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 30 November 2017. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) The role of financial statements analysis is to use financial reports prepared by companies, combined with other information, to evaluate the past, current and potential performance and financial position of a company for the purpose of making investment, credit and other economic decisions.

In relation to the above statement, analyse four types of economic decisions that a financial analyst could make from the financial statements of a company. (4 marks)

(b) (i) Explain the term "earnings management". (2 marks)

(ii) John Kitili, a financial analyst at Rich Investment Firm has been presented with the following data from the statement of financial position of Mwenja Dairy Limited for analysis:

Mwenja Dairy Limited statement of financial position as at 31 October:

	2017 Sh. "000"	2016 Sh. "000"
Assets:		
Cash	4,400	4,000
Accounts receivable	7,000	6,000
Inventory	8,400	8,000
Non-current assets	27,600	26,000
Total assets	47,400	44,000
Liabilities and equity:		
Accounts payable	3,520	3,200
Short-term notes payable	5,288	4,800
Long-term debt	30,000	30,000
Total liabilities	38,808	38,000
Equity:		
Ordinary shares	4,600	4,000
Retained earnings	3,992	2,000
Total liabilities and equity	47,400	44,000

Required:

The accrual ratio for the year 2017. (4 marks)

(c) The following information relates to Zalip Limited and Avela Limited which operates wholesale stores as at 30 June 2017:

Statement of financial position as at 30 June 2017

	Zalip Limited Sh. "million"	Avela Limited Sh. "million"
Non-current assets:		
Land and buildings	360.0	510.0
Fixtures and fittings	87.0	91.2
	447.0	601.0
Current assets:		
Inventories	592.0	403.0
Trade receivables	176.4	321.9
Cash at bank	84.6	91.6
	853.0	816.5
Total assets	1,300.0	1,417.7

	Sh. "million"	Sh. "million"
Equity and liabilities:		
Equity		
Ordinary shares (Sh.1 each)	320.0	250.0
Retained earnings	367.6	624.6
Total equity	687.6	874.6
Non-current liabilities:		
Borrowings – loan notes	190.0	250.0
Current liabilities:		
Trade payables	406.4	275.7
Taxation	16.0	17.4
	422.4	293.1
Total equity and liabilities	1,300.0	1,417.7

Income statement for the year ended 30 June 2017

	Zalip Limited Sh. "million"	Avela Limited Sh. "million"
Revenue	1,478.1	1,790.4
Cost of sales	(1,018.3)	(1,214.9)
Gross profit	459.8	575.5
Operating expenses	(308.5)	(408.6)
Operating profit	151.3	166.9
Interest payable	(19.4)	(27.5)
Profit before taxation	131.9	139.4
Taxation	(32.0)	(34.8)
Profit for the year	99.9	104.6

Additional information:

1. All purchases and sales were on credit.
2. Zalip Limited and Avela Limited had announced their intention to pay dividends of Sh.135 million and Sh.95 million respectively in respect of the year 2017.
3. The market value of a share in Zalip Limited and Avela Limited at the end of the year were Sh.6.50 and Sh.8.20 respectively.

Required:
For each business, calculate two ratios that are concerned with each of the following aspects:

(i) Profitability. (2 marks)

(ii) Efficiency. (2 marks)

(iii) Liquidity. (2 marks)

(iv) Gearing. (2 marks)

(d) Interpret the ratios computed in (c) (i) to (c) (iv) above. (2 marks)

(Total: 20 marks)

QUESTION TWO

(a) Evaluate four factors that could contribute to the reliability of financial statements. (4 marks)

(b) Benson Kilonzo, a financial analyst at ABC Capital has been presented with the following financial statements of Venus Limited for analysis:

Venus Limited
Income statement for the year ended 31 October 2017

	Sh.
Revenue	3,257,489
Cost of sales	(840,204)
Gross profit	2,417,285
Less expenses:	
Salaries and wages	1,036,005
Rent and lighting	123,467
General administrative expenses	783,969
Total operating expenses	(1,943,441)
Earnings before interest, tax, depreciation and amortisation (EBIDA)	473,844

	Sh.
Depreciation and amortisation	(156,368)
Earnings before interest and tax (EBIT)	317,476
Interest and other expenses	(31,089)
Pre-tax income	286,387
Income taxes	(85,642)
Net income	200,745

Venus Limited
Statement of financial position as at 31 October:

	2016	2017
Non-current assets:	**Sh.**	**Sh.**
Land and buildings	1,694,720	1,774,550
Plant and equipment	618,084	663,472
Motor vehicles	15,001	23,965
	2,327,805	2,461,987
Accumulated depreciation	(1,295,761)	(1,418,835)
Non-current assets	1,032,044	1,043,152
Goodwill	216,605	252,790
	1,248,649	1,295,942
Current assets:		
Cash	73,633	62,271
Inventory	67,023	70,559
Accounts receivable	46,588	43,944
Total current assets	187,244	176,774
Total assets	1,435,893	1,472,716
Financed by:		
Equity and liabilities:		
Equity:		
Ordinary share capital	507,736	512,735
Retained earnings	(586,196)	(725,834)
Total shareholders' equity	(78,460)	(213,099)
Long-term liabilities:		
Loan notes	970,825	1,113,949
Current liabilities:		
Trade payables	412,112	427,160
Accrued expenses	131,416	144,706
Total liabilities and equity	1,435,893	1,472,716

Required:

(i) Vertical analysis on the income statement for the year ended 31 October 2017. (4 marks)

(ii) Horizontal analysis on the statement of financial position. (4 marks)

(iii) Inventory turnover ratio. (2 marks)

(iv) Cash conversion cycle. (4 marks)

(v) Return on equity (ROE). (2 marks)

(Total: 20 marks)

QUESTION THREE

(a) Highlight three conditions to be satisfied before provision is recognised as per the International Accounting Standard (IAS) 37 "provision, contingent liabilities and contingent assets". (3 marks)

(b) Medichem Limited, a public limited company operating in the pharmaceuticals sector intends to achieve economies of scale by entering into a business combination with compatible partner companies. To achieve this objective, Medichem Limited acquired all of the ordinary share capital of Diapharm Limited by way of a share exchange on 1 April 2017. Medichem Limited issued 5 of its own shares for every 4 shares in Diapharm Limited. The market value of Medichem Limited's share on 1 April 2017 was Sh.6 each. The share issue has not been recorded in Medichem Limited's books.

The summarised financial statements of both companies for the year to 30 September 2017 were as follows:

Income statement for the year ended 30 September 2017:

	Medichem Limited Sh. "000"	Diapharm Limited Sh. "000"
Sales revenue	48,000	40,000
Cost of sales	(33,200)	(23,600)
Gross profit	14,800	16,400
Operating expenses	(3,200)	(2,000)
Profit before tax	11,600	14,400
Taxation	(4,000)	(6,000)
Profit for the year	7,600	8,400

Statement of financial position as at 30 September 2017:

	Medichem Limited		Diapharm Limited	
Non-current assets:	Sh. "000"	Sh. "000"	Sh. "000"	Sh. "000"
Property, plant and equipment		128,000		70,000
Investments		-		25,600
		128,000		95,600
Current assets:				
Inventory	45,600		47,200	
Trade receivables	32,800		48,400	
Bank	1,000	79,400	400	96,000
Total assets		207,400		191,600
Equity and liabilities:				
Ordinary shares (Sh.1 each)		40,000		24,000
Share premium	8,000		4,800	
Retained earnings	114,400	122,400	85,400	90,200
		162,400		114,200
Non-current liabilities:				
8% loan note		10,000		36,000
Current liabilities:				
Trade payables	30,600		35,400	
Taxation	4,400	35,000	6,000	41,400
		207,400		191,600

Additional information:

1. The fair value of Diapharm Limited investment was Sh.10 million in excess of its book value at the date of acquisition.
2. The fair value of Diaphram Limited's other net assets was equal to the book value.
3. Goodwill was reviewed on 30 September 2017. Sh.6 million loss is to be recognised.
4. No dividends have been paid or proposed by either companies.

Required:

(i) Consolidated income statement for the year ended 30 September 2017. (5 marks)

(ii) Consolidated statement of changes in equity for the year ended 30 September 2017. (4 marks)

(iii) Consolidated statement of financial position as at 30 September 2017. (8 marks)

(Total: 20 marks)

QUESTION FOUR

(a) In relation to the International Accounting Standard (IAS) 38 "Intangible Assets":

(i) Define the term "intangible asset". (2 marks)

(ii) Outline three examples of intangible assets. (3 marks)

(b) The following information relates to Golden Cake Limited pension scheme for the year ended 31 October 2017:

Beginning projected benefit obligation (PBO)	Sh.24 million
Fair market value of plan assets	Sh.16 million
Discount rate	9%
Expected return on plan assets	Sh.1.96 million

Anticipated compensation growth rate	4%
End of period actual return on assets	14%
End of period plan assets	Sh.18 million
Service cost for the year	Sh.1.8 million

Note: Ignore amortisation of unrecognised prior service costs and deferred gains and losses.

Required:
Pension expenses for the year ended 31 October 2017. (3 marks)

(c) Milliam Akinyi is a financial analyst at Vinball Limited which operates a defined-benefit retirement plan for its employees. The firm has a relatively young workforce with a low percentage of retirees. She is tasked to analyse the effects of changing assumptions on different variables used to calculate certain pension amounts.

Required:
(i) Describe the impact of an increase in the compensation growth. (2 marks)

(ii) Examine the impact of the funded status in case of a decrease in the discount rate. (1 mark)

(d) Stella Maris, a Certified Financial and Investment Analyst (CIFA) has calculated the following ratios for ABC Limited:

Operating profit margin	17.5%
Net profit margin	11.7%
Total asset turnover	0.89 times
Return on assets	10.4%
Financial leverage	1.46
Debt to equity ratio	0.46

Required:
The company's return on equity (ROE) using DuPont analysis. (2 marks)

(e) In relation to International Accounting Standard (IAS) 10 "Events after the reporting period":

(i) Distinguish between "adjusting event" and "non-adjusting event". (4 marks)

(ii) The current financial year for Damiano Limited ends on 31 March 2017. The company's financial statements were authorised by its directors on 6 May 2017 and the annual general meeting (AGM) was held on 3 June 2017. The following events have been brought to your attention:

On 12 April 2017, a fire completely destroyed the company's largest warehouse and the inventory inside. The carrying amount of the warehouse and the inventory were Sh.20 million and Sh.12 million respectively. It appears that the company had not updated the value of its insurance cover and only expects to be able to recover a maximum of Sh.18 million from its insurers. Damiano Limited trading operations had been severely disrupted since the fire outbreak and it expects large trading losses in the foreseeable future.

Required:
Explain the required treatment of the above item by Damiano Limited in its financial statements for the year ended 31 March 2017. (3 marks)

(Total: 20 marks)

QUESTION FIVE

(a) (i) Explain the term "shenanigan strategies" as used in financial statements analysis. (2 marks)

(ii) Describe two basic strategies underlying accounting shenanigans. (2 marks)

(b) In March 2017, Nebulax Limited acquired 40,000 shares in Jedidah Limited for Sh.2.68 per share. The investment was classified as available for sale on initial recognition. The shares were trading at Sh.2.96 per share on 31 July 2017. The directors of Nebulax Limited are concerned about the value of the company's investment in Jedidah Limited and in an attempt to hedge against the risk of a fall in its value, they are considering acquiring a derivative contract. The directors wish to use hedge accounting in accordance with International Accounting Standard (IAS) 39: "Financial Instruments".

Required:
Explain how both the available for sale investment and any associated derivative contract would be subsequently accounted for, assuming that the criteria for hedge accounting was met, in accordance with IAS 39. (3 marks)

(c) ABK Ltd. a subsidiary of MNC Ltd., prepares its financial statements in AHS currency. The following financial information relates to the two entities for the year ended 30 September 2017:

Statement of financial position as at 30 September 2017:

	MNC Ltd.		ABK Ltd.	
	SHS "million"	SHS "million"	AHS "million"	AHS "million"
Non-current assets:				
Property, plant and equipment	107		164	
Investments (Note 1)	60	167	-	164
Current assets:				
Inventory (Note 2)	70		50	
Accounts receivable	65		60	
Cash and bank balances	25	160	12	122
		327		286
Equity and liabilities:				
Ordinary share capital (1SHS/1 AHS shares)	100		60	
Retained profits	127	227	89	149
Non-current liabilities		65		72
Current liabilities		35		65
		327		286

Statement of comprehensive income for the year ended 30 September 2017

	MNC Ltd.	ABK Ltd.
	SHS "million"	AHS "million"
Revenue	200	240
Cost of sales	(120)	(145)
Gross profit	80	95
Operating expenses	(35)	(40)
Operating income	45	55
Intergroup investment income	4.5	
Finance cost	(7.5)	(10)
Profit before tax	42	45
Income tax expense	(10)	(15)
	32	30

Notes to the financial statements:

Note 1: On 1 October 2014, when the retained earnings of ABK Ltd. showed a credit balance of AHS 38 million, MNC Ltd. purchased 45 million shares of ABK Ltd. for AHS 4 each. At this date, a non-current asset in the books of ABK Ltd. with a carrying value of AHS 50 million was deemed to have a fair value of AHS 80 million. This asset had a remaining useful life of 10 years at this time and depreciation is charged to cost of sales.

Note 2: On 1 September 2017, MNC Ltd. sold computer components to ABK Ltd. for SHS 12 million. These components had a cost of SHS 10 million to manufacture. All of these components were included in the inventory of ABK Ltd. as at 30 September 2017. ABK Ltd. had paid for half of the consignment before the year end and the balance of the liabilities was included in its payables.

Exchange rate on relevant dates were as follows:

Date	**Exchange rate: (AHS/SHS)**
1 October 2014	3.00
30 September 2016	2.70
1 September 2017	2.45
30 September 2017	2.40

The weighted average exchange rate for the year ended 30 September 2017 was AHS 2.50 = 1 SHS

Required:
MNC Ltd. consolidated statement of comprehensive income for the year ended 30 September 2017. (8 marks)

(d) Radian Limited had 10 million ordinary shares in issue on both 1 January 2016 and 31 December 2016. On 1 January 2016, Radian Limited issued 1.2 million, 1 unit of 5% convertible loan stock. Each unit of stock is convertible into 4 ordinary shares on 1 January 2019 at the option of the holder.

The following is an extract from Radian Limited income statement for the year ended 31 December 2016:

	Sh. "000"
Profit before interest and tax	1,960
Interest payable on 5% convertible stock	(60)
Profit before tax	1,900
Income tax expenses at 30%	(570)
Profit for the year	1,330

Required:

(i) The basic earnings per share (EPS) for the year ended 31 December 2016. (2 marks)

(ii) The diluted earning per share (EPS) for the year ended 31 December 2016. (3 marks)

(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 25 May 2017. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Nancy Naliaka, a financial analyst at ABC Capital Investment firm is analysing the financial statements of some companies in the manufacturing sector in her country.

Required:
In relation to the above statement, highlight three different types of information that she could obtain from each of the following sources:

(i) Press release. (3 marks)

(ii) Proxy statements. (3 marks)

(b) Noor Kiptoon, a finance director at Equid Limited is evaluating whether the company should purchase a production plant in cash or through a finance lease.

Additional information:
1. The plant will cost Sh.280 million.
2. The interest rate implicit in the lease is 10% per annum.
3. The finance lease would be repaid in four equal instalments of Sh.80 million each, payable annually in advance commencing 1 January 2017.

Required:
The amount to be included in both the statement of comprehensive income and the statement of financial position for the years ended 31 December 2017 and 31 December 2018. (6 marks)

(c) (i) Distinguish between "taxable temporary differences" and "deductable temporary differences" as used in the computation of income taxes. (2 marks)

(ii) Bitech Ltd. had a deferred tax assets of Sh.20 million as at 1 April 2016.
During the year ended 31 March 2017, the following information was available for computation of deferred tax:

1. Property, plant and equipment had a carrying amount of Sh.600 million and a tax base of Sh.500 million.
2. Trade receivables had been reported at Sh.250 million before making an allowance for doubtful debts of Sh.5 million and exchange gain (unrealised) of Sh.20 million. Both the allowance and exchange gain are not allowed for tax purposes.
3. Trade and other payables stood at Sh.550 million which included accrual of Sh.60 million allowable for tax purposes.
4. Inventory is carried at Sh.150 million before making a provision of 5% on obsolete stock.
5. Intangible assets comprise of patents being amortised over 5 years which had a carrying value of Sh.60 million. This had been allowed for tax purposes when the cost was incurred.

Assume a tax rate of 30%.

Required:
The deferred tax provision for the year ended 31 March 2017. (6 marks)
(Total: 20 marks)

QUESTION TWO

(a) (i) Explain four purposes of financial ratios. (4 marks)

(ii) James Oduor, a financial analyst is examining the performance of Betam Airways and wishes to understand the factors driving the trend in its return on equity (ROE) over a three year period. James obtains the following data from a leading news provider and ascertains that the news provider has included non-operating income in the interest burden factor:

Factor	2016	Year 2015	2014
Return on equity (ROE)	20.62%	14.42%	10.17%
Tax burden	64.88%	62.52%	60.67%
Interest burden	130.54%	112.60%	130.50%
Earnings before interest and tax (EBIT) margin	6.51%	6.40%	4.84%
Asset turnover	1.55	1.38	1.19
Leverage	2.42	2.32	2.24

Required:

Analyse each of the factors driving the trend in return on equity (ROE) over the three year period. (6 marks)

(b) The following are extracts of the financial statements of Aquila Ltd., Leo Ltd. and Orion Ltd. for the year ended 31 December 2016:

Summarised income statements and other income for the year ended 31 December 2016:

	Aquila Ltd. Sh."million"	Leo Ltd. Sh."million"	Orion Ltd. Sh."million"
Profit from operations	580	280	140
Finance costs	(90)	(16)	(20)
Profit before tax	490	264	120
Income tax expense	(160)	(64)	(30)
Profit for the year	330	200	90
Other comprehensive income:			
Items that will not be classified to the income statement:			
Revaluation of property (net of tax)	120	40	20
Other comprehensive income for the year	120	40	20
Total comprehensive income	450	240	110

Additional information:

1. Aquila Ltd. acquired 80% of the equity share capital of Leo Ltd. for Sh.405 million in the year 2013 when the fair value of the net assets was Sh.465 million. The non-controlling interest in Leo Ltd. was measured as its fair value of Sh.100 million at the date of acquisition. Aquila Ltd. conducted an annual impairment review and concluded that the goodwill on the acquisition of Leo Ltd. was impaired by 20% as at 31 December 2016. No previous impairment of goodwill had occurred.
2. Aquila Ltd. established a joint venture entity, Orion Ltd., with one other party on 1 January 2016. Aquila Ltd. is accounting for its 50% share in this joint venture in accordance with the International Accounting Standard (IAS) 28: "Investment in Associates and Joint Ventures".

Required:

(i) The summarised consolidated income statement and other comprehensive income for Aquila Ltd. for the year ended 31 December 2016. (6 marks)

(ii) Aquila Ltd. is planning to acquire 100% of the equity of Delta Ltd., an entity that operates overseas and which currently prepares its financial statements in E Shillings. The directors of Aquila Ltd. intend to require that Delta Ltd. adopts the currency of Aquila Ltd.'s country as its functional currency.

Required:

Explain how the functional currency of Delta Ltd. should be determined under International Accounting Standard (IAS) 21: "The effects of changes in Foreign exchange rates" framework. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) (i) Summarise four conditions that must be satisfied before the revenue from the sale of goods could be recognised as per the International Accounting Standard (IAS) 18: "Revenue". (4 marks)

(ii) Fairmall Technology Limited was awarded a contract to develop a computer software program for a client for a total sales price of Sh.100 million.
The project was to take three years to develop with a total development cost estimated at Sh.60 million.

Additional information:

1. At the end of year 1, the company had spent Sh.30 million, total costs to completion being estimated at Sh.30 million.
2. At the end of year 2, the company had spent an additional Sh.24 million, total costs to completion being estimated at Sh.6 million.
3. At the end of year 3, the contract was complete. The company spent an accumulated total cost of Sh.60 million.
4. The company recognises long-term contract revenue using the percentage of completion method and estimates the percentage complete based on expenditure incurred as a percentage of total estimated expenditures.

Required:
The amount of revenue that Fairmall Technology Limited should recognise in year 1, year 2 and year 3. (6 marks)

(b) The following comprehensive income statement relates to the performance of Beste Ltd. for the year ended 31 March 2017 and 31 March 2016 respectively:

	31 March 2017 Sh."000"	31 March 2016 Sh."000"
Revenue	141,088	122,516
Cost of sales	(71,956)	(67,400)
Gross profit	69,132	55,116
Distribution costs	(11,054)	(9,830)
Administrative expenses	(29,702)	(22,278)
Total operating profit	28,376	23,008
Profit/(loss) on sale of non-current assets	(1,418)	1,240
Profit before interest and taxation	26,958	24,248
Net interest payable	(5,508)	(6,438)
Profit before taxation	21,450	17,810
Taxation	(6,244)	(4,470)
Profit for the period	15,206	13,340

Required:

(i) Common size percentage income statement for the year ended 31 March 2017 and 31 March 2016. (8 marks)

(ii) Comment on your results in (b)(i) above. (2 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Examine two limitations of cash flow reporting. (2 marks)

(b) The following information relates to Maji Ltd.:

	Sh."000"
Cash and cash equivalents (31 December 2016)	1,500
Cash and cash equivalents (31 December 2017)	1,850
Interest expense	480
Net borrowings	250
Cash dividends	1,250

The corporation tax rate is 30%.

Required:
The free cash flow to the firm (FCFF) at the end of year 2017. (3 marks)

(c) The following are the financial statements for Halzina Limited for the year ended 30 April 2017:

Halzina Limited
Income statement for the year ended 30 April 2017:

	Sh."000"
Revenue	5,106
Cost of sales	(3,628)
Gross profit	1,478
Distribution costs	(250)
Administrative expenses	(528)
Profit from operations	700
Interest received	50
Interest paid	(150)
Profit before tax	600
Income tax expenses	(280)
Profit for the year	320
Dividend payable	200

Halzina Limited
Statement of financial position as at 30 April:

	2017 Sh."000"	2016 Sh."000"
Assets:		
Non-current assets:		
Tangible assets	760	610
Intangible assets	500	400
Investment	-	50
	1.260	1.060
Current assets:		
Inventories	[illegible]00	204
Trade receivables	780	630
Short-term investments	100	-
Cash	4	2
	1.184	836
Total assets	2.444	1.896
Equity and liabilities:		
Equity:		
Ordinary share capital of Sh. 1 each	400	300
Share premium account	320	300
Revaluation reserve	200	182
Retained earnings	320	200
	1.240	982
Non-current liabilities:		
Long-term loan	340	100
Current liabilities:		
Trade payables	254	238
Bank overdraft	170	196
Taxation	240	220
Dividends payable	200	160
	864	814
Total equity and liabilities	2.444	1.896

Additional information:

1. The proceeds of the sale of non-current asset investments amount to Sh.60,000.
2. Fixtures and fittings with an original cost of Sh.170,000 and a carrying value of Sh.90,000 were sold for Sh.64,000 during the year.
3. New fixtures and fittings were purchased at a cost of Sh.402,000.

4. The following information relates to tangible non-current assets:

	30 April 2017 Sh."000"	30 April 2016 Sh."000"
Cost/revaluations	1,440	1,190
Accumulated depreciation	680	580
Carrying value	760	610

5. 100,000 ordinary shares of Sh.1 each were issued during the year at a premium of Sh.0.20 per share.
6. The short-term investments are highly liquid and are close to maturity.

Required:
Statement of cash flows for the year ended 30 April 2017 in accordance with the requirements of International Accounting Standard (IAS) 7: "Statement of cash flows". (15 marks)
(Total: 20 marks)

QUESTION FIVE

(a) Evaluate five mechanisms that could be put in place to prevent strategic manipulation of financial statements. (5 marks)

(b) During the year 2016, OLB Ltd. reported a net income of Sh.115,600 and had 200,000 ordinary shares outstanding for the entire year. The company also had 1,000, 10% Sh.100 par value convertible preferred shares, convertible into 40 ordinary shares each, outstanding for the entire year.
OLB Ltd. also had 600, 7% Sh.1,000 par value convertible bonds, convertible into 100 shares each, outstanding for the entire year. The company also had 10,000 stock options outstanding during the year. Each option is convertible into one share of stock at Sh.15 per share. The average market price of the stock for the year was Sh.20.

The corporate tax rate is 30%.

Required:
The diluted earnings per share (EPS) for OLB Ltd. for the year 2016. (5 marks)

(c) Fahari Ltd. operates a defined benefit pension plan for its employees. On 1 April 2016, the fair value of the pension plan assets was at Sh.8,200,000 and the present value of pension plan liabilities was Sh.8,500,000.
The actuary estimated that the service cost for the year to 31 March 2017 was Sh.2,100,000. The pension plan paid Sh.500,000 to retired members and Fahari Ltd. paid Sh.1,900,000 in contributions to the pension plan in the year to 31 March 2017. The actuary estimated that the relevant discount rate for the year to 31 March 2017 was 6%.

On 31 March 2017, Fahari Ltd. announced improvements to the benefits offered by the pension plan to all of its members. The actuary estimated that the past service cost associated with these improvements was Sh.2 million.
At 31 March 2017, the fair value of the pension plan assets was Sh.10,200,000 and the present value of the pension plan liabilities including the past service cost was Sh.12,500,000.

Required:
In accordance with International Accounting Standard (IAS) 19: "Employee Benefits":

(i) Calculate the net actuarial gain or loss that will be included in Fahari Ltd.'s other comprehensive income for the year ended 31 March 2017. (8 marks)

(ii) Calculate the net pension asset or liability that will be included in Fahari Ltd.'s statement of financial position as at 31 March 2017. (2 marks)
(Total: 20 marks)

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KASNEB

CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 24 November 2016. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) Analyse six steps that a financial analyst could follow when analysing financial statements of an entity. (6 marks)

(b) The following information was obtained from the records of Faridah Limited for the year ended 31 August 2016:

	Sh."000"
Prior-period adjustment - credit to retained earnings	10,000
Gain on sale of plant assets	42,000
Cost of goods sold	760,000
Income tax expense (savings):	
Continuing operations	64,000
Discontinued operations	16,000
Extraordinary gain	20,000
Preference shares, 8% Sh.100 par value	100,000
Dividends	32,000
Retained earnings, beginning as originally reported	206,000
Treasury stock, common (10,000 shares at cost)	50,000
Selling expenses	156,000
Ordinary shares (90,000 shares issued)	360,000
Sales revenue	1,240,000
Interest expense	60,000
Extraordinary gain	52,000
Income from discontinued operations	40,000
Loss due to lawsuit	22,000
General expenses	124,000

Assume a corporation tax rate of 40%.

Required:

(i) A single-step income statement (with all revenues and gains grouped together) for the year ended 31 August 2016.
Note: Include the earnings per share (EPS) presentation and show computations. Assume no changes in the share prices during the year. (8 marks)

(ii) Statement of retained earnings for the year ended 31 August 2016. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) Examine three warning signs that might indicate that the financial statements of a company are of a poor quality. (6 marks)

(b) The following financial information relates to Movida Limited for the year ended 30 September 2016:

		Sh."000"
Closing inventories:	Raw materials	150,000
	Work in Progress	60,000
	Finished goods	200,000
Purchases		500,000
Trade accounts receivable		230,000
Trade accounts payable		120,000
Sales		900,000
Cost of goods sold		750,000

Required:

The operating cycle of Movida Limited for the year ended 30 September 2016. (6 marks)

(c) The following balances were obtained from the books of Paloma Limited as at 31 March 2016:

	Debit Sh."000"	Credit Sh."000"
Building	500,000	
Provision for depreciation on building		75,000
Plant at cost	120,000	
Equity shares: (Sh.10 par value)		200,000
Retained earnings (1 April 2015)		375,000
Revaluation reserves		50,000
Interim dividends paid	5,000	
Bank	522,000	
Revenue		873,500
Cost of sales	243,500	
Operating expenses	183,000	
	1,573,500	1,573,500

Additional information:

1. Paloma Limited made a rights issue on 1 October 2015 of 1 share for every 5 shares held at a price of Sh.15 each. The market price per share being Sh.20.
2. A final dividend of 10% to be paid to equity shareholders.
3. A general reserve to be created and Sh.30,000,000 be transferred from retained earnings.

Required:
Statement of changes in equity for the year ended 31 March 2016. (4 marks)

(d) The following information relates to Eagle Limited defined benefit plan for the year ended 31 December 2015:

	Sh."000"
Fair value of plan assets	950
Present value of pension liability	800
Present value of future refunds and reductions in future contributions	70

Required:
The value of the plan assets to be recognised in the financial statements of Eagle Limited for the year ended 31 December 2015. (4 marks)

(Total: 20 marks)

QUESTION THREE

(a) Describe four categories of financial instruments as per the International Accounting Standard (IAS) 39 "Financial instruments". (4 marks)

(b) On 1 February 2016, Ndovu Limited acquired 80% of the ordinary share capital of Simba Limited at a cost of Sh.10.28 million. On the same date, Ndovu Limited also acquired 50% of Simba Limited's 10% loan notes at par. The market price of each of the Simba Limited's share at the date of acquisition was Sh.6.

The summarised draft financial statements of both companies are as follows:

Statement of comprehensive income as at 31 October 2016:

	Ndovu Limited Sh."000"	Simba Limited Sh."000"
Revenue	60,000	24,000
Cost of sales	(42,000)	(20,000)
Gross profit	18,000	4,000
Operating expenses	(6,000)	(200)
Loan interest received/(paid)	75	(200)
Profit before tax	12,075	3,600
Taxation	(3,000)	(600)
Profit for the year	9,075	3,000

Statement of financial position as at 31 October 2016:

	Ndovu Limited Sh."000"	Simba Limited Sh."000"
Tangible non-current assets	19,320	8,000
Investment	11,280	-
	30,600	8,000
Current assets	15,000	8,000
Total assets	45,600	16,000
Equity and liabilities:		
Equity:		
Ordinary shares (Sh.1 par value)	10,000	2,000
Retained earnings	25,600	8,400
	35,600	10,400
Non-current liabilities:		
10% loan notes	-	2,000
Current liabilities	10,000	3,600
Total equity and liabilities	45,600	16,000

Additional information:

1. The fair values of Simba Limited's assets were equal to their book values with the exception of its plant which had a fair value of Sh.3,200,000 in excess of its book value at the date of acquisition. The remaining useful life of all Simba Limited's plant at the date of acquisition was four years and this period has not changed as a result of the acquisition.
2. Depreciation of plant is on a straight line basis and is charged to cost of sales. Simba Limited has not adjusted the value of its plant as a result of the fair value exercise.
3. In the past acquisition period, Ndovu Limited sold goods to Simba Limited at a price of Sh.12 million. These goods had cost Ndovu Limited Sh.9 million. During the year, Simba Limited had sold Sh.10 million (at cost to Simba Limited) of these goods for Sh.15 million.
4. Ndovu Limited bears almost all of the administration costs incurred on behalf of the group such as invoicing and credit control. It does not charge Simba Limited for this service as to do so would not have a material effect on the group profit.
5. Revenue and profits should be deemed to accrue evenly throughout the year.
6. The current accounts of the two companies were reconciled at the year end with Simba Limited owing Ndovu Limited Sh.750,000.
7. Ndovu Limited has a policy of valuing non-controlling interest at fair value at the date of acquisition. For this purpose, the share price of Simba Limited should be used.
8. An impairment test on 31 October 2016 showed that consolidated goodwill should be written down by Sh.400,000.

Required:

(i) Consolidated statement of comprehensive income for the year ended 31 October 2016. (8 marks)

(ii) Consolidated statement of financial position as at 31 October 2016. (8 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Discuss four limitations of segment reporting requirements. (4 marks)

(b) For the year ended 31 December 2015, GreatDreams Company Limited reported cash flow from operating activities of Sh.163 million, income from continuing operations of Sh.146 million and total revenue of Sh.852 million. Review of GreatDreams' footnotes revealed the following:

1. In the year 2015, GreatDreams' pension contribution was Sh.35 million higher than in previous year. This typical contribution is not expected to continue in the foreseeable future.
2. Included in the income from continuing operations was Sh.17 million one time non-cash charge. The charge is not deductible for income tax purposes.
3. The corporation tax rate is 30%.

Required:

GreatDreams Company Limited excess cash margin. (4 marks)

(c) Explain three ways in which operating leases could impact on the financial statements. (3 marks)

(d) The following information was obtained from the financial statement notes of Kisumu United Ltd. and Tigania Products Ltd. for the year ended 31 December 2015:

	Item	Kisumu United Ltd.	Tigania Products Ltd
1.	Goodwill	The company amortises goodwill over 20 years.	The company amortises goodwill over 5 years.
2.	Property, plant and equipment	The company uses a straight line depreciation method over the economic lives of the assets which range from 5 to 20 years for buildings.	The company uses an accelerated depreciation method over the economic lives of the assets which range from 5 to 20 years for buildings.
3.	Accounts receivable	The company uses a bad debt allowance of 2% of accounts receivable.	The company uses a bad debt allowance of 5% of accounts receivable.

Required:

By comparing the performance of each company in relation to items 1, 2 and 3 above, identify which company has the higher quality of earnings. (9 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following are the financial statements of Quittet Limited for the year ended 31 October 2015 and 31 October 2016:

Quittet Limited
Cash flow statement for the year ended 31 October:

	2015 Sh."000"	2016 Sh."000"
Cash flow from operating activities:		
Profit before interest and tax	2,293	162
Adjustment for:		
• Investment income	-	(55)
• Finance cost	165	102
• Depreciation	262	369
• Loss on disposal of investments	101	-
• Profit on disposal of plant	(2,502)	(2)
	319	576
Working capital changes:		
Increase in inventories	(709)	(201)
Decrease in receivables	532	256
Increase in payables	727	251
Cash flow from operating activities	869	882
Less: Interest paid	(165)	(102)
Tax paid	(13)	(49)
Net cash flow from operating activities	691	731

	2016 Sh."000"	2015 Sh."000"
Cash flow from investing activities:		
Dividends received	-	55
Proceeds from sale of investments	32	-
Proceeds from sale of plant	1,609	12
Net cash flow from investing activities	1,641	67

	Sh."000"	Sh."000"
Cash flow from financing activities:		
Dividend paid	-	(110)
Borrowings	500	100
Net cash flow from financing activities	500	(10)
Net change in cash and cash equivalent2,832	788	
Cash and cash equivalent at the beginning	910	122
Cash and cash equivalent at the end	3,742	910

The extracts from the income statement and statement of financial position for the same period were as follows:

	2016	2015
	Sh."000"	Sh."000"
Revenue	2,201	3,102
Equity and liabilities:		
Ordinary share capital (Sh.1 par value)	100	100
Retained earnings	7,052	4,772
	7,152	4,872
Long term liabilities:		
Borrowings	1,500	1,000
Current liabilities:		
Trade and other payables	1,056	329
	9,708	6,201

Required:
Calculate the following cash flow items:

(i) Cash return. (2 marks)

(ii) Cash return on capital employed ratio. (2 marks)

(iii) Cash flow to operating profit ratio. (2 marks)

(iv) Cash interest cover ratio. (2 marks)

(v) Cash flow per share. (2 marks)

(b) The financial controller of Quittet Limited has been under pressure from his operational director to improve the figures in (a)(i) to (v) above in readiness for the upcoming Annual General Meeting (AGM).

Discuss how this pressure might have influenced the financial statements and the reporting in general. (2 marks)

(c) Ivy Maritim, an investment and financial analyst at Faida Capital Investment Services has prepared the following proforma income statement for PinBall Limited for the year ended 30 September 2016:

	Sh."million"
Net sales	6,000
Cost of goods sold	(2,850)
Gross profit	3,150
Selling, general and administration expenses	(1,780)
Depreciation	(280)
Goodwill amortisation	(25)
Operating income	1,065
Interest expense	(170)
Income before taxes	895
Income tax	(300)
Net income	595
Diluted Earnings per Share (EPS) (Sh.)	2.29
Average shares outstanding (millions)	260
Dividends per Share (DPS) (Sh.)	0.64

Ivy Maritim is interested in forecasting the earnings per share (EPS) for the year 2017 and has made the following assumptions for the year 2017, compared with the year 2016:

1. Unit sales will rise by 7% but prices will remain the same.
2. Synergies from acquisitions will add an additional Sh.200 million to net sales.
3. Gross margin as a percentage of net sales will improve by 1.5%.
4. Selling, general and administration expenses as a percentage of sales will improve by 0.7%.
5. Depreciation expense will rise by 5%.
6. Goodwill amortisation will rise by Sh.10 million.
7. Long-term debt will remain the same.
8. Interest rates will decrease, reducing interest expense by Sh.10 million.
9. The income tax rate will rise by 0.5%.
10. Average shares outstanding will remain the same.
11. Dividends per share (DPS) will rise by 10%.

Required:
Projected income statement for PinBall Limited for the year ended 30 September 2017. (8 marks)
(Total: 20 marks)

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CIFA PART II SECTION 3

FINANCIAL STATEMENTS ANALYSIS

THURSDAY: 26 May 2016. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) (i) Differentiate between "top down investing" and "bottom up investing" as an approach to analysing financial statements of a firm. (4 marks)

(ii) Outline three limitations of financial analysis. (3 marks)

(b) On 1 January 2013, Dualmax Limited granted 100 cash share appreciation rights (SARs) to each of its 500 employees on condition that the employees remain in its employment for at least the next two years. The SARs vest on 31 December 2014 and could be exercised at any time up to 31 December 2015. The fair value of each SAR at the grant date is Sh.7.40. The following information has also been provided:

Year ended	Leavers	Number of employees exercising rights	Outstanding SARs	Estimated further leavers	Fair value of SARs Sh.	Intrinsic value (cash paid) Sh.
31 December 2013	50	-	450	60	8.00	-
31 December 2014	50	100	300	-	8.50	8.10
31 December 2015	-	300	-	-	-	9.00

Required:
The expense and liability which will appear in the financial statements in each of the three years. (6 marks)

(c) The directors of Zedmark Ltd. have been presented with the following abridged financial statements:

Zedmark Ltd.
Income statement for the year ended 30 September:

	2014		2015	
	Sh."000"	Sh."000"	Sh."000"	Sh."000"
Sales revenue		3,600		3,840
Cost of sales:				
Opening inventories	320		400	
Purchases	2,240		2,350	
	2,560		2,750	
Closing inventories	(400)	(2,160)	(500)	(2,250)
Gross profit		1,440		1,590
Expenses		1,360		1,500
Profit		80		90

Zedmark Ltd.
Statement of financial position as at 30 September:

	2014	2015
	Sh."000"	Sh."000"
Non-current assets:		
Property, plant and equipment	1,900	1,860
Current assets:		
Inventories	400	500
Trade receivables	750	960
Cash at bank	8	4
	1,158	1,464
Total assets	3,058	3,324
Equity and liabilities:		
Equity		
Ordinary shares (Sh.1 each)	1,650	1,766
Reserves	1,018	1,108
	2,668	2,874
Current liabilities	390	450
Total equity and liabilities	3,058	3,324

Required:

(i) Calculate three profitability ratios and three efficiency ratios for the years ended 30 September 2014 and 30 September 2015. (6 marks)

(ii) Comment on the profitability and efficiency of the company using the ratios calculated in (c)(i) above. (1 mark)

(Total: 20 marks)

QUESTION TWO

(a) In a recent seminar on,the requirements of International Financial Reporting, many investments and financial analysts commented on a growing disillusionment with the usefulness and reliability of the information contained in some companies income statements.

With reference to the above statement, discuss the extent to which a company's statement of cash flow could be more useful and reliable than its income statement. (6 marks)

(b) The following are the comprehensive financial statements of Bozi Limited for the year ended 31 March 2015 and 31 March 2016:

Bozi Limited
Comprehensive income statement for the year ended 31 March 2016:

	Sh."000"
Revenue	5,106
Cost of sales	(3,628)
Gross profit	1,478
Distribution cost	(250)
Administrative expenses	(528)
Profit from operations	700
Interest received	50
Interest paid	(150)
Profit before tax	600
Income tax expense	(280)
Profit for the year	320
Dividend payable	200

Bozi Limited
Statement of financial position as at 31 March:

	2016 Sh."000"	2015 Sh."000"
Assets:		
Non-current assets:		
Tangible assets	760	610
Intangible assets	500	400
Investments	-	50
Current assets:		
Inventories	300	204
Trade receivables	780	630
Short-term investments	100	-
Cash in hand	4	2
Total assets	2,444	1,896
Equity and liabilities:		
Equity:		
Ordinary share capital (Sh.1 par value)	400	300
Share premium	320	300
Revaluation reserves	200	182
Retained earnings	320	200
Non-current liabilities:		
Long-term loan	340	100
Current liabilities:		
Trade payables	254	238
Bank overdraft	170	196
Taxation	240	220
Dividend payable	200	160
Total equity and liabilities	2,444	1,896

Additional information:

1. The proceeds of the sale of non-current assets investments amounted to Sh.60,000.
2. Fixtures and fittings with original cost of Sh.170,000 and a carrying value of Sh.90,000 were sold for Sh.64,000. During the year, new fixtures and fittings were purchased costing Sh.402,000.
3. The following information relates to tangible non-current assets as at 31 December:

	2014 Sh."000"	2015 Sh."000"
Cost/revaluation	1,440	1,190
Accumulated depreciation	680	580
Carrying value	760	610

4. 100,000 Sh.1 ordinary shares were issued during the year at a premium of Sh.0.20 per share.
5. The short-term investments are highly liquid and are close to maturity.

Required:

Bozi Limited Statement of Cash Flows for the year ended 31 March 2016 in accordance with the requirements of International Accounting Standards (IAS) 7 ("Statement of Cash flows"). Use the indirect method. (14 marks)

(Total: 20 marks)

QUESTION THREE

(a) Examine three techniques that could be used in financial model building and forecasting. (3 marks)

(b) On 1 January 2014, Mobizon Limited, a manufacturing company, leased a cast iron making machine for four years. The lease calls for payment of Sh.12 million per year payable at the beginning of the year. At the end of the four years, Mobizon Limited will return the machine to the lessor who will sell it for scrap. The appropriate interest rate is 9%. Mobizon Limited depreciates its assets on a straight line basis.

Required:

Total expense under finance lease to be reported in the income statement for the year ended 31 December 2015. (4 marks)

(c) Apex Limited had 3,600,000 ordinary shares in issue on 1 January 2015. The profit after tax for the year ended 31 December 2015 was Sh.2,700,000.

Additional information:

1. On 1 July 2015, the company made a rights issue at a price of Sh.9.50 per share on the basis of one share for every five shares held. The share price immediately prior to the rights issue had been Sh.12.50 per share.
2. On 1 April 2015, Apex Limited issued Sh.5,000,000 7% convertible bonds at a discount rate of 5% to their par value. The terms of issue provided that the bond can be either redeemed for cash at par value or be converted into ordinary shares on 31 March 2018.
3. Each Sh.10 bond is convertible into two new ordinary shares. The proceeds of the convertible bonds issue have been credited to non-current liabilities.
4. The interest is payable annually in arrears commencing 31 March 2016. The effective rate of interest on an equivalent bond without the option to convert to ordinary shares would be 11% per annum.
5. The earnings per share (EPS) for the year ended 31 December 2014 was Sh.0.8.
6. Assume a corporate tax rate of 30%.

Required:

(i) The initial carrying amount of the convertible bond in both liability and equity component. (4 marks)

(ii) Basic earnings per share (EPS) for the year ended 31 December 2015. (4 marks)

(iii) Adjusted EPS for the year ended 31 December 2014 as it should be disclosed in the year 2015. (1 mark)

(iv) Diluted EPS for the year ended 31 December 2015. (4 marks)

(Total: 20 marks)

QUESTION FOUR

(a) (i) Explain the term "creative accounting" as used in the analysis of financial statements. (1 mark)

(ii) Propose five ways in which creative accounting could take place in an organisation. (5 marks)

(b) On 1 January 2011, A Ltd., a public limited company acquired 60% of B Ltd., a public limited company. On 30 July 2009, A Ltd. had acquired 10% of C Ltd. and on the same day B Ltd. had acquired 80% of C Ltd.

The following are the statements of financial position of the three companies as at 31 December 2015:

	A Ltd. Sh."million"	B Ltd. Sh."million"	C Ltd. Sh."million"
Non-current assets:			
Property, plant and equipment	2,458	1,410	870
Investment in B Ltd.	900		
Investment in C Ltd.	27	240	
	3,385	1,650	870
Current assets:			
Inventories	450	200	260
Trade receivables	610	365	139
Cash	240	95	116
	1,300	660	515
	4,685	2,310	1,385
Equity:			
Ordinary share capital	500	200	100
Share premium	250	120	50
Retained earnings	2,805	1,572	850
	3,555	1,892	1,000
Current liabilities:			
Trade payables	1,130	418	385
	4,685	2,310	1,385

Additional information:

1. During the year ended 31 December 2015, B Ltd. sold goods to C Ltd. for Sh.260 million including a mark up of 25%. All of these goods remained in the inventories at the year end.
2. The retained earnings of the three companies at the acquisition dates was as follows:

	30 July 2009 Sh."million"	1 January 2011 Sh."million"
A Ltd.	1,610	1,860
B Ltd.	700	950
C Ltd.	40	100

3. The book values of the identifiable net assets at the acquisition date are equivalent to their fair values.
4. On 1 January 2011, the fair value of A Ltd. was 10% holding and in C Ltd. was Sh.50 million.
5. A Ltd. and B Ltd. hold their investment in subsidiaries at cost in their separate financial statements. It is group policy to value the non controlling interests at fair value at acquisition. The directors valued the non controlling interests in B Ltd. at Sh.536 million and C Ltd. at Sh.210 million on 1 January 2011.
6. No impairment losses have been necessary in the consolidated financial statements to date.

Required:

Group consolidated statement of financial position as at 31 December 2015. (14 marks)

(Total: 20 marks)

QUESTION FIVE

(a) On 1 July 2013, Quorondom Limited issued a redeemable debt instrument at a par value of Sh.6 million. The instrument carries a fixed coupon interest at a rate of 6% payable annually in arrears. The debt instrument will be redeemable for Sh.6.02 million on 30 June 2017. Transaction costs associated with the issue were Sh.200,000 and were paid at the time of the issue. The approximate interest rate applicable to this liability is 7.06%.

Required:

The carrying value of the liability to be included in Quorondom Limited in the statement of financial position as at 30 June 2015.

Note: (Round all workings to the nearest Sh."000"). (3 marks)

(b) Kesty Ltd. made taxable trading profits of Sh.1,200,000 for the year ended 30 April 2016 on which corporation tax is payable at a rate of 30%. A transfer of Sh.20,000 will be made to the deferred taxation account. The balance on this account was Sh.100,000 before making any adjustments for the following items:

1. The estimated tax on profits for the year ended 30 April 2015 was Sh.80,000 but tax has been agreed at Sh.84,000 and fully paid.

2. Tax on profits for the year to 30 April 2016 is payable in arrears.

3. In the year to 30 April 2016, the company made a capital gain of Sh.60,000 on the sale of some property.

The capital gain is taxable at a rate of 30%.

Required:

(i) The tax charge for the year to 30 April 2016. (4 marks)

(ii) The tax liabilities in the statement of financial position. (4 marks)

(c) (i) Explain the three components of DuPont equation. (6 marks)

(ii) An investment and financial analyst gathered the following information about Farasi Holdings Limited for the year ended 31 December 2015:

	Sh."000"
Revenue	1,000
Net income	400
Total assets	500
Shareholders' equity	10,000

Required:

The company's return on equity (ROE) using DuPont analysis. (3 marks)

(Total: 20 marks)

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Present Value of 1 Received at the End of n Periods:

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	.9901	9804	9709	9615	.9524	.9434	.9346	.9259	.9174	.9091
2	.9803	.9612	.9426	9246	9070	8900	8734	.8573	.8417	.8264
3	9706	.9423	.9151	8890	.8638	.8396	.8163	7938	7722	.7513
4	.9610	.9238	.8885	.8548	.8227	.7921	.7629	.7350	7084	.6830
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	6499	.6209
6	.9420	.8880	.8375	.7903	.7462	.7050	.6663	.6302	.5963	.5645
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4665
9	.9143	.8368	.7664	.7026	.6446	.5919	.5439	.5002	.4604	.4241
10	.9053	.8203	.7441	.6756	.6139	.5584	.5083	.4632	.4224	.3855
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	3555	.3186
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3262	.2897
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	3152	2745	.2394
16	.8528	.7284	.6232	.5339	.4581	.3936	.3387	.2919	.2519	.2176
17	8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799
19	8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635
20	.8195	.6730	.5537	.4564	.3769	.3118	.2584	.2145	.1784	.1486
25	.7798	.6095	4776	.3751	.2953	.2330	.1842	.1460	1160	.0923
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573
40	.6717	.4529	3066	.2083	.1420	.0972	.0668	0460	.0318	.0221
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033

Period	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.8929	8772	8696	.8621	.8475	.8333	.8065	.7813	7576	7353
2	.7972	7695	7561	.7432	.7182	.6944	.6504	.6104	5739	.5407
3	7118	6750	6575	.6407	.6086	.5787	.5245	.4768	4348	.3975
4	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.5674	5194	4972	.4761	.4371	.4019	.3411	2910	.2495	.2149
6	.5066	.4556	.4323	4104	.3704	.3349	.2751	.2274	1890	.1580
7	.4523	.3996	.3759	.3538	.3139	.2791	.2218	:1776	.1432	.1162
8	.4039	3506	.3269	.3050	.2660	.2326	.1789	.1388	.1085	.0854
9	.3606	3075	.2843	.2630	.2255	.1938	.1443	.1084	.0822	.0628
10	.3220	.2697	.2472	.2267	.1911	.1615	.1164	.0847	.0623	0462
11	.2875	.2366	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.2567	.2076	.1869	1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.2292	1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0184
14	.2046	.1597	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	0099
16	.1631	.1229	1069	.0930	.0708	.0541	.0320	.0193	.0118	0073
17	.1456	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.1300	.0946	.0808	.0691	.0508	.0376	.0208	.0118	.0068	.0039
19	.1161	.0829	0703	.0596	.0431	0313	.0168	.0092	.0051	.0029
20	1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	0005
30	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.0107	.0053	.0037	.0026	.0013	.0007	.0002	.0001	*	*
50	.0035	.0014	.0009	.0006	.0003	.0001	*	*	*	*
60	.0011	.0004	.0002	.0001	*	*	*	*	*	*

* The factor is zero to four decimal places

Present Value of an Annuity of 1 Per Period for n Periods:

$$PVIF_{r,t} = \sum_{t=1}^{n} \frac{1}{(1+r)^t} = \frac{1-\frac{1}{(1+r)^n}}{r}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091
2	1.9704	1.9416	1.9135	1.8861	1.8594	1.8334	1.8080	1.7833	1.7591	1.7355
3	2.9410	2.8839	2.8286	2.7751	2.7232	2.6730	2.6243	2.5771	2.5313	2.4869
4	3.9020	3.8077	3.7171	3.6299	3.5460	3.4651	3.3872	3.3121	3.2397	3.1699
5	4.8534	4.7135	4.5797	4.4518	4.3295	4.2124	4.1002	3.9927	3.8897	3.7908
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7665	4.6229	4.4859	4.3553
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8684
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2098	5.9713	5.7466	5.5348	5.3349
9	8.5660	8.1622	7.7861	7.4353	7.1078	6.8017	6.5152	6.2469	5.9952	5.7590
10	9.4713	8.9826	8.5302	8.1109	7.7217	7.3601	7.0236	6.7101	6.4177	6.1446
11	10.3676	9.7868	9.2526	8.7605	8.3064	7.8869	7.4987	7.1390	6.8052	6.4951
12	11.2551	10.5753	9.9540	9.3851	8.8633	8.3838	7.9427	7.5361	7.1607	6.8137
13	12.1337	11.3484	10.6350	9.9856	9.3936	8.8527	8.3577	7.9038	7.4869	7.1034
14	13.0037	12.1062	11.2961	10.5631	9.8986	9.2950	8.7455	8.2442	7.7862	7.3667
15	13.8651	12.8493	11.9379	11.1184	10.3797	9.7122	9.1079	8.5595	8.0607	7.6061
16	14.7179	13.5777	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237
17	15.5623	14.2919	13.1661	12.1657	11.2741	10.4773	9.7632	9.1216	8.5436	8.0216
18	16.3983	14.9920	13.7535	12.6593	11.6896	10.8276	10.0591	9.3719	8.7556	8.2014
19	17.2260	15.6785	14.3238	13.1339	12.0853	11.1581	10.3356	9.6036	8.9501	8.3649
20	18.0456	16.3514	14.8775	13.5903	12.4622	11.4699	10.5940	9.8181	9.1285	8.5136
25	22.0232	19.5235	17.4131	15.6221	14.0939	12.7834	11.6536	10.6748	9.8226	9.0770
30	25.8077	22.3965	19.6004	17.2920	15.3725	13.7648	12.4090	11.2578	10.2737	9.4269
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9246	10.7574	9.7791
50	39.1961	31.4236	25.7298	21.4822	18.2559	15.7619	13.8007	12.2335	10.9617	9.9148
60	44.9550	34.7609	27.6756	22.6235	18.9293	16.1614	14.0392	12.3766	11.0480	9.9672

Number of payments	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.8929	0.8772	0.8696	0.8621	0.8475	0.8333	0.8065	0.7813	0.7576
2	1.6901	1.6467	1.6257	1.6052	1.5656	1.5278	1.4568	1.3916	1.3315
3	2.4018	2.3216	2.2832	2.2459	2.1743	2.1065	1.9813	1.8684	1.7663
4	3.0373	2.9137	2.8550	2.7982	2.6901	2.5887	2.4043	2.2410	2.0957
5	3.6048	3.4331	3.3522	3.2743	3.1272	2.9906	2.7454	2.5320	2.3452
6	4.1114	3.8887	3.7845	3.6847	3.4976	3.3255	3.0205	2.7594	2 5342
7	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775
8	4.9676	4.6389	4.4873	4.3436	4.0776	3.8372	3.4212	3.0758	2.7860
9	5.3282	4.9464	4.7716	4.6065	4.3030	4.0310	3.5655	3.1842	2.8681
10	5.6502	5.2161	5.0188	4.8332	4.4941	4.1925	3.6819	3.2689	2 9304
11	5.9377	5.4527	5.2337	5.0286	4.6560	4.3271	3.7757	3.3351	2 9776
12	6.1944	5.6603	5.4206	5.1971	4.7932	4.4392	3.8514	3.3868	3.0133
13	6.4235	5.8424	5.5831	5.3423	4.9095	4.5327	3.9124	3.4272	3.0404
14	6.6282	6.0021	5.7245	5.4675	5.0081	4.6106	3.9616	3.4587	3 0609
15	6.8109	6.1422	5.8474	5.5755	5.0916	4.6755	4.0013	3.4834	3 0764
16	6.9740	6.2651	5.9542	5.6685	5.1624	4.7296	4.0333	3.5026	3.0882
17	7.1196	6.3729	6.0472	5.7487	5.2223	4.7746	4.0591	3.5177	3.0971
18	7.2497	6.4674	6.1280	5.8178	5.2732	4.8122	4.0799	3.5294	3.1039
19	7.3658	6.5504	6.1982	5.8775	5.3162	4.8435	4.0967	3.5386	3.1090
20	7.4694	6.6231	6.2593	5.9288	5.3527	4.8696	4.1103	3.5458	3 1129
25	7.8431	6.8729	6.4641	6.0971	5.4669	4.9476	4.1474	3.5640	3 1220
30	8.0552	7.0027	6.5660	6.1772	5.5168	4.9789	4.1601	3.5693	3 1242
40	8.2438	7.1050	6.6418	6 2335	5.5482	4.9966	4.1659	3.5712	3.1250
50	8.3045	7.1327	6.6605	6.2463	5.5541	4.9995	4.1666	3.5714	3 1250
60	8.3240	7.1401	6.6651	6.2402	5.5553	4.9999	4.1667	3.5714	3 1250