FINANCIAL REPORTING AND ANALYSIS

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Synapse Global Institute comprises a team of accomplished young professionals who have excelled in diverse fields, including Certified Public Accountancy, Civil Engineering (Registered), and Supply Chain Management (Registered)

The Institution embodies the concept of a synapse, serving as a vital connection between educators and learners to enable seamless knowledge transfer

Bridging educators' expertise with learners' ambitions, it delivers accessible, transformative education tailored for today's interconnected world, shaping futures through innovation and excellence

PREFACE

Financial Reporting and Analysis

Financial reporting is central to communicating the performance, position, and progress of any organisation. It forms the backbone of transparency and accountability in both the private and public sectors. As such, mastering this area is essential for anyone pursuing a career in accounting and finance.

This book, ***Financial Reporting and Analysis***, has been developed to provide a thorough and practical foundation in financial reporting for students preparing for professional accountancy qualifications, particularly the Certified Public Accountant (CPA) and the Association of Chartered Certified Accountants (ACCA). It brings together key principles, standards, and analytical tools in a clear, accessible, and exam-ready format.

Importantly, this book has been written to fully cover the CPA Paper No. 9: Financial Reporting and Analysis syllabus (KNQF Level 7), and addresses all examinable areas in depth.

Designed with the learner in mind, this book adopts a practical, example-driven approach to help students understand complex concepts and apply them confidently in both academic and professional settings. The material is structured to align with current international reporting standards, including IFRS and IPSAS, and includes coverage of financial reporting for various types of entities—such as companies, professional firms, public sector organisations, and entities with group structures like subsidiaries and branches.

Key features of this book include:

- Comprehensive coverage of all major topics in financial reporting and analysis.
- Use of real-world examples, financial statement extracts, and step-by-step journal entries.
- Practical scenarios involving trial balances and adjustments.
- Analysis techniques, including ratio interpretation and common size statements.
- Integration of both private and public sector reporting frameworks.

Whether you are preparing for exams, teaching financial reporting, or seeking to strengthen your professional understanding, this book is intended to serve as a reliable companion. It reflects a commitment to high-quality, student-focused learning that bridges theory with real-world application.

We hope this book enhances your learning experience and equips you with the confidence to succeed in your financial reporting journey.

CPA Ronoh Benson Benhard
Synapse Global Institute
2025

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CHAPTER ONE

ACCOUNTING FOR ASSETS AND LIABILITIES

INVESTMENT PROPERTY (IAS 40)

Investment property is a distinct category of assets that plays a significant role in financial reporting. It represents property (land or buildings) held to earn rental income, capital appreciation, or both, rather than for use in production, administration, or sale in the ordinary course of business.

Definition of Investment Property

According to IAS 40 (Investment Property), investment property is:

- Land or a building (or part of a building) held to earn rentals, capital appreciation, or both.
- It is not used in the production or supply of goods or services, for administrative purposes, or for sale in the ordinary course of business.

Examples of Investment Property

- Land held for long-term capital appreciation.
- A building leased out under an operating lease.
- Property under construction or development for future use as investment property.
- Land held for an unspecified future use, as long as it is not for sale in the ordinary course of business.

Recognition of Investment Property

Investment property is recognised as an asset when:

1. It is probable that future economic benefits associated with the property will flow to the entity.
2. The cost of the property can be reliably measured.

Initial Measurement of Investment Property

- At cost, which includes purchase price, transaction costs, and directly attributable costs such as legal fees and property transfer taxes.

- If acquired through a business combination, it is measured at fair value at acquisition date.
- If exchanged for another asset, it is measured at fair value, unless the transaction lacks commercial substance.

Subsequent Measurement of Investment Property

Entities can choose one of the following models for subsequent measurement:

1. Cost Model (IAS 16 – Property, Plant and Equipment rules apply):
    - The property is carried at cost less accumulated depreciation and impairment losses.
    - Depreciation is charged systematically over the useful life of the asset.
    - Impairment is assessed periodically.
2. Fair Value Model:
    - The property is measured at fair value, with changes recognised in the profit or loss.
    - Fair value reflects market conditions at the reporting date.
    - No depreciation is charged under this model.

Journal Entries for Investment Property

1. Initial Recognition at Cost
   Suppose a company purchases an investment property for Ksh. 10 million, with legal and transfer fees amounting to Ksh. 500,000.

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Investment Property	10,500,000	
xx/xx/xx	Bank		10,500,000

2. Depreciation under the Cost Model (Assume a useful life of 40 years, straight-line depreciation)
    - Annual depreciation = Ksh. 10,500,000 ÷ 40 = Ksh. 262,500

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Depreciation Expense	262,500	
xx/xx/xx	Accumulated Depreciation		262,500

3. Revaluation Gain under the Fair Value Model (Assume fair value increases to Ksh. 12 million)

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Investment Property	1,500,000	
xx/xx/xx	Revaluation Gain (Profit or Loss)		1,500,000

4. Rental Income Earned from Investment Property (Assume monthly rent of Ksh. 100,000 received in cash)

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Cash	100,000	
xx/xx/xx	Rental Income (Profit or Loss)		100,000

Transfers and Disposal of Investment Property

Investment property can be transferred to or from another category under specific circumstances:

- Transfer to owner-occupied property (IAS 16) or inventory (IAS 2) if the purpose of the asset changes.
- Transfer from inventory or owner-occupied property when the entity decides to hold it for rental income or capital appreciation.

Example: Transfer to Owner-Occupied Property

- If a company decides to use its investment property for administrative purposes, it transfers the property at its fair value.
- Assume a property with a carrying amount of Ksh. 15 million is transferred to PPE at a fair value of Ksh. 18 million.

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Property, Plant & Equipment (PPE)	18,000,000	
xx/xx/xx	Investment Property		15,000,000
xx/xx/xx	Revaluation Gain (OCI)		3,000,000

Disclosure Requirements

Entities must disclose:

- Whether they apply the cost model or fair value model.
- The carrying amount of investment property at the beginning and end of the period.
- Rental income and expenses related to investment property.

- Restrictions on investment property such as legal encumbrances.

Example

ABC Ltd owns a building it leases to tenants. The company initially purchases the building for Ksh. 50 million and chooses to use the fair value model. At year-end, the building's fair value increases to Ksh. 55 million. ABC Ltd should record the gain in the profit or loss.

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Investment Property	5,000,000	
xx/xx/xx	Fair Value Gain (Profit or Loss)		5,000,000

If ABC Ltd later sells the property for Ksh. 60 million, the gain is recognised as follows:

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Bank	60,000,000	
xx/xx/xx	Investment Property		55,000,000
xx/xx/xx	Profit on Sale of Investment Property		5,000,000

Illustrative Example: Investment Property (IAS 40)

Question

ABC Ltd, a real estate investment company, purchased a commercial building on 1st January 2023 for Ksh. 50 million to earn rental income. The company incurred Ksh. 2 million in legal and transaction costs.

- On 31st December 2023, an independent valuer estimated the fair value of the property to be Ksh. 58 million.
- The company accounts for investment property using the fair value model under IAS 40.
- The company received Ksh. 5 million in rental income during the year and incurred Ksh. 1 million in property management expenses.

Required:

1. Prepare the journal entries to record the purchase, fair value adjustments, rental income, and expenses for the year ended 31st December 2023.
2. Extract the relevant sections of the Statement of Financial Position and Statement of Profit or Loss for the year ended 31st December 2023.

Solution

Step 1: Recognising the Purchase of Investment Property

Since the property is an investment property under IAS 40, the company initially records it at cost, including transaction costs.

Journal Entry on 1st January 2023

Date	Account	Debit (Ksh.)	Credit (Ksh.)
01/01/2023	Investment Property	52,000,000	
01/01/2023	Cash/Bank		52,000,000

📌 Explanation: The cost includes the purchase price of Ksh. 50 million plus transaction costs of Ksh. 2 million.

Step 2: Recognising Rental Income

Rental income from investment property is recognised as revenue under IAS 40.

Journal Entry for Rental Income

Date	Account	Debit (Ksh.)	Credit (Ksh.)
31/12/2023	Cash/Bank	5,000,000	
31/12/2023	Rental Income		5,000,000

📌 Explanation: The company earned Ksh. 5 million from renting out the property.

Step 3: Recognising Property Management Expenses

Property management expenses are recorded as an expense in the Statement of Profit or Loss.

Journal Entry for Expenses

Date	Account	Debit (Ksh.)	Credit (Ksh.)
31/12/2023	Property Management Expense	1,000,000	
31/12/2023	Cash/Bank		1,000,000

📌 Explanation: Ksh. 1 million was spent on property maintenance and management.

Step 4: Recognising Fair Value Adjustment

IAS 40 requires companies using the fair value model to revalue investment property at each reporting date. The fair value increased from Ksh. 52 million to Ksh. 58 million, resulting in a gain of Ksh. 6 million.

Journal Entry for Fair Value Gain

Date	Account	Debit (Ksh.)	Credit (Ksh.)
31/12/2023	Investment Property	6,000,000	
31/12/2023	Fair Value Gain (Profit or Loss)		6,000,000

📌 Explanation: The increase in fair value is recorded as a gain in the profit or loss statement.

Step 5: Extracts from Financial Statements

Statement of Profit or Loss (Extract) for the Year Ended 31st December 2023

Particulars	Ksh. ('000)
Rental Income	5,000
Less: Property Management Expenses	(1,000)
Fair Value Gain on Investment Property	6,000
Net Profit from Investment Property	10,000

📌 Explanation:
✅ Rental income of Ksh. 5 million is recognised as revenue.
✅ Ksh. 1 million is deducted as property management expenses.
✅ A fair value gain of Ksh. 6 million is included in profit.
✅ Total profit from investment property is Ksh. 10 million.

Statement of Financial Position (Extract) as at 31st December 2023

Assets	Ksh. ('000)	Liabilities & Equity	Ksh. ('000)
Non-Current Assets		Equity	
Investment Property	58,000	Retained Earnings	10,000
Total Assets	58,000	Total Liabilities & Equity	58,000

📌 Explanation:
✅ The investment property is recorded at its fair value of Ksh. 58 million.
✅ The fair value gain is included in retained earnings, increasing equity.

IFRS 6 – EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

The exploration and evaluation of mineral resources involve identifying and assessing the technical and commercial viability of extracting natural resources such as oil, gas, and minerals. Given the unique risks and uncertainties associated with these activities, IFRS 6 (Exploration for and Evaluation of Mineral Resources) provides guidance on how companies should recognise, measure, and disclose exploration and evaluation expenditures.

Definition of Exploration and Evaluation Assets

Exploration and evaluation assets refer to expenditures incurred by an entity in connection with the search for mineral resources before determining whether extraction is feasible. These assets include:

- The cost of topographical, geological, geochemical, and geophysical studies.
- Exploratory drilling, trenching, and sampling.
- The cost of technical feasibility and commercial viability studies.
- Acquisition costs of rights to explore for mineral resources.

Recognition of Exploration and Evaluation Assets

An entity recognises exploration and evaluation costs as an asset when it meets the definition of an asset and follows the entity's chosen accounting policy. IFRS 6 allows flexibility, meaning companies can decide whether to capitalise or expense these costs based on their accounting policies.

Journal Entry for Initial Recognition

Assume a company incurs Ksh. 10 million on geological surveys and drilling as part of exploration. If the company chooses to capitalise the costs, the journal entry is:

Date	Account	Debit (Ksh.)	Credit (Ksh.)
xx/xx/xx	Exploration and Evaluation Assets	10,000,000	
xx/xx/xx	Cash/Bank		10,000,000

Measurement of Exploration and Evaluation Assets

Companies can choose to measure exploration and evaluation assets using:

1. Cost Model
    - The asset is recorded at historical cost and amortised or impaired over time.
2. Revaluation Model (only if fair value can be determined)

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