KASNEB

CPA PART II SECTION 3

FINANCIAL REPORTING

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) For public sector entities with limited internally generated funds, external borrowings may constitute a viable alternative source of finance. Such borrowings are usually accessed at a cost.

Required:
In the context of International Public Sector Accounting Standard (IPSAS) 5 - Borrowing Costs:

(i) Identify three items that could be considered as borrowing costs. (3 marks)

(ii) Describe the two alternative accounting treatments for borrowing costs. (4 marks)

(b) Government grants are a common source of finance in developing economies.

Required:

(i) Explain the term "government grants" in the context of International Financial Reporting Standards (IFRSs). (3 marks)

(ii) Government grants may be accounted for using either the "income" approach or the "capital" approach.

Discuss the arguments for each of the two approaches above. (6 marks)

(c) Evaluate four criteria for consideration of a lease as a capital lease. (4 marks)

(Total: 20 marks)

QUESTION TWO

The following trial balance relates to Dodoma Ltd. as at 30 April 2016:

	Sh."000"	Sh."000"
Revenue		315,000
Inventory	32,000	
Raw materials purchased	150,000	
Production cost	60,000	
Distribution cost	12,000	
Administrative expenses	22,000	
Lease rentals paid	23,000	
Property, plant and equipment:		
- Cost	180,000	
- Accumulated depreciation (1 May 2015)		35,000
Income tax account	400	
Deferred tax		7,200
Trade receivables	50,000	
Cash and cash equivalents	24,800	
Trade payables		30,000
Ordinary share capital		154,000
Ordinary dividend paid	30,000	
Retained earnings		43,000
	584,200	584,200

Additional information:

1. On 20 April 2016, Dodoma Ltd. agreed with a customer to supply goods in the month of June 2016. The customer paid a deposit of Sh.5,000,000 which Dodoma Ltd. credited to its revenue account. Dodoma Ltd. has not made any adjustments to inventory on account of the deposit.
2. A stock take was done on 30 April 2016 that showed closing inventory at a cost of Sh.40,000,000. However, there were some damaged goods with a cost of Sh.4,000,000 that required to be repaired at a cost of Sh.400,000 and then sold for Sh.3,500,000.
3. On 1 May 2015, Dodoma Ltd. entered into two leasing contracts as explained below:

   Contract A
   The contract was to lease motor vehicles for a two year period. The estimated useful life of the vehicles at the start of the lease was 5 years. It was the responsibility of the lessor to repair and insure the vehicles. The lease stated that Dodoma Ltd. should pay a deposit of Sh.600,000 at the start of the lease followed by monthly payments of Sh.200,000 in arrears. The lease rentals figure for the year ended 30 April 2016 includes Sh.3,000,000 in respect of this lease. The vehicles were to be used by office staff.

   Contract B
   The contract was to lease a number of machines. The lease was for a four year period which was the estimated useful life of the machines. Dodoma Ltd. was required to repair and insure the machines which would have no residual value at the end of the lease. The lease rentals were set at Sh.10,000,000 every six months payable in advance. The lease rental figure for the year includes Sh.20,000,000 in respect of this lease. The rate of interest implicit in this lease was 5% per six months period. The fair value of the machines at inception of the lease was estimated at Sh.70,000,000.

4. Property, plant and equipment included:

	Cost	Accumulated depreciation
	Sh."000"	Sh."000"
Property	90,000	5,000
Plant and equipment	90,000	30,000
	180,000	35,000

   - The plant and equipment is being depreciated on a straight line basis at a rate of 25% per annum.
   - The depreciable element of the property has an allocated carrying value of Sh.50,000,000 and is being depreciated on a straight line basis over 50 years from the date of original purchase. On 1 May 2015, the directors of Dodoma Ltd. revalued this property for the first time. The property had an estimated market value of Sh.100,000,000 as at 1 May 2015. It is further estimated that Sh.54,000,000 of this value relates to the depreciable element.

     The directors have decided not to make a transfer of excess depreciation on the revalued asset to retained earnings. Depreciation on all property, plant and equipment should be charged to cost of sales.

5. The estimated income tax liability for the year ended 30 April 2016 is Sh.5,000,000. The balance on the income tax account in the trial balance is the residue of the previous year after making the payment for that year.

6. A transfer of Sh.600,000 needs to be made to the deferred tax account for the period.

7. Trade receivables include an amount of Sh.10,000,000 owed by a customer who experienced cash flow problems prior to the year end. Dodoma Ltd. agreed to accept a payment of Sh.8,000,000 in full and final settlement of the debt and to defer the payment until April 2017. The expected return on sums invested for one year is 10%.

Required:

(a) Statement of comprehensive income for the year ended 30 April 2016. (10 marks)

(b) Statement of financial position as at 30 April 2016. (10 marks)

(Total: 20 marks)

QUESTION THREE

Faith and Hope were partners in a business of manufacturing and distributing construction materials, sharing profits and losses equally. The partners agreed that with effect from 1 January 2016, the business be split off and transferred to two separate companies; Mabati Ltd. and Nyumba Ltd. Mabati Ltd. took over the manufacturing business while Nyumba Ltd. took over the distribution business.

The partnership's statement of financial position as at 31 December 2015 was as follows:

		Sh."000"	Sh."000"
Non-current assets			
Land and building (at cost)			200,000
Motor vehicles (net book value)			150,000
Equipment (net book value)			33,000
			383,000
Current assets			
Cash in hand		1,000	
Account receivables:	Manufacturing	128,000	
	Distribution	216,000	
Inventory:	Manufacturing	460,000	
	Distribution	225,000	1,030,000
			1,413,000
Capital and liabilities			
Capital:	Faith	526,000	
	Hope	324,000	850,000
Non-current liability			
Bank loan			24,000
Current liabilities			
Bank overdraft		179,000	
Account payables:	Manufacturing	308,000	
	Distribution	52,000	539,000
			1,413,000

Additional information:

1. Mabati Ltd. took over all the non-current assets, cash, bank overdraft and its share of account receivables, inventory and account payables. Nyumba Ltd. took its share of account receivables, inventory and account payables. The assets and liabilities were transferred at book values and the partners were paid Sh.100 million being goodwill for the distribution business and Sh.80 million being goodwill for the manufacturing business.
2. The bank that had provided the loan agreed to accept Sh.14.4 million 10% debentures in Mabati Ltd. and Sh.9.6 million 10% debentures in Nyumba Ltd.
3. On 1 January 2016, the purchase consideration was settled by the allotment of fully paid ordinary shares of Sh.20 each in the respective companies as follows:

   Faith: 23,750,000 shares in Mabati Ltd. and the balance in shares in Nyumba Ltd.

   Hope: 15,920,000 shares in Nyumba Ltd. and the balance in shares in Mabati Ltd.

4. Mabati Ltd. also raised a 12% debenture of Sh.200 million on 1 January 2016 and paid-off the bank overdraft. The expenses incurred in raising the 12% debenture amounted to Sh.7 million.
5. Mabati Ltd. and Nyumba Ltd. also issued 1,000,000 and 1,500,000 fully paid ordinary shares of Sh.20 each respectively to two corporate investors, A Ltd. and B Ltd. on 1 January 2016.
6. None of the companies has amortised the goodwill.
7. The formation expenses were paid by the respective companies as follows:

	Sh. "million"
Mabati Ltd.	13
Nyumba Ltd.	8

Required:

Prepare the following accounts in a columnar format where applicable:

(a) Business purchases accounts. (6 marks)

(b) Partners' capital accounts. (2 marks)

(c) Bank account. (2 marks)

(d) Vendor's account. (2 marks)

(e) Statements of financial position for the two companies after formation. (8 marks)

(Total: 20 marks)

QUESTION FOUR

Jamii Ltd is a listed company operating in the service industry. During the year ended 30 April 2016, the company acquired two companies, Bora Ltd. and Njema Ltd. as part of its expansion plan. The following statements of comprehensive income relate to Jamii Ltd. and its investee companies Bora Ltd. and Njema Ltd. for the year ended 30 April 2016:

	Jamii Ltd. Sh. "million"	Bora Ltd. Sh. "million"	Njema Ltd. Sh. "million"
Revenue	102,180	52,800	33,150
Cost of sales	(76,635)	(36,990)	(26,520)
Gross profit	25,545	15,810	6,630
Investment income	584	60	-
	26,129	15,870	6,630
Operating expenses:			
Distribution expenses	(12,810)	(7,260)	(2,880)
Administrative expenses	(7,779)	(4,815)	(1,695)
Finance costs	(720)	(600)	(45)
Profit before taxation	4,820	3,195	2,010
Income tax expense	(1,530)	(1,125)	(645)
Profit after tax	3,290	2,070	1,365
Other comprehensive income:			
Revaluation of intangible asset	-	530	-
Total comprehensive income	3,290	2,600	1,365

Additional information:

1. On 1 May 2015, Jamii Ltd. acquired 80% of 1,125 million ordinary shares of Sh.10 each in Bora Ltd. for Sh.18,000 million. As at that date, the share premium account of Bora Ltd. had a balance of Sh.3,750 million while retained profit was Sh.3,705 million.
2. On 1 November 2015, Jamii Ltd. acquired 50% of 600 million ordinary shares of Sh.10 each of Njema Ltd. for Sh.6,300 million. As at that date, the share premium account of Njema Ltd. had a balance of Sh.1,500 million. The retained profit as at 1 May 2015 was Sh.2,085 million. The profit of Njema Ltd. accrued evenly throughout the year. The investment should be accounted for using the equity method.
3. On the date of acquisition of Bora Ltd., the property, plant and equipment of the company had a fair value which was in excess of book value by Sh.390 million, with a remaining useful life of 5 years.
4. The fair value of net assets acquired in Njema Ltd. approximated the book value as at the date of acquisition.
5. During the year ended 30 April 2016, Bora Ltd. sold goods worth Sh.6,000 million to Jamii Ltd. Bora Ltd. had marked up the goods by 25% above the cost. One quarter of these goods were included in the closing inventory of Jamii Ltd.
6. The goodwill arising on acquisition of the investee companies had suffered impairment losses to the extent of 25% during the year ended 30 April 2016. The group's policy is to apply the partial goodwill method.

Required:

(a) Computation of goodwill on each investment. (4 marks)

(b) Group statement of comprehensive income for the year ended 30 April 2016. (12 marks)

(c) Group statement of changes in equity for the year ended 30 April 2016. (4 marks)

(Total: 20 marks)

QUESTION FIVE

(a) With reference to International Accounting Standard (IAS) 10 "Events After the Reporting Period", explain the following terms:

(i) Events after the reporting period. (2 marks)

(ii) Adjusting events. (2 marks)

(iii) Non-adjusting events. (2 marks)

(b) The following trial balance was extracted from the books of Maendeleo Bank Ltd. as at 31 March 2016:

	Sh. "000"	Sh. "000"
Property, plant and equipment	28,854	
Interest on loans and advances		16,790
Interest on customers deposits	10,616	
Customers deposits		164,460
Share capital		20,000
Revaluation reserve		4,960
Salaries and wages	4,368	
Borrowed funds		7,040
Directors emoluments	1,290	
Depreciation on plant and equipment	1,630	
Other interest income		860
Specific provisions for doubtful debts		5,500
Interest on government securities		9,536
Other operating expenses	3,260	
Repairs and maintenance	420	
Printing and stationery	556	
Deposits and placements due from other banks	17,120	
Loans and advances to customers	135,310	
Deposits and placements due to other banks		12,820
Interest received on deposits and placements with other banks		7,600
Other interest expense	628	
Interest paid on deposits and placements from other banks	2,560	
Cash and balances with Central Bank	7,260	
Interim dividends paid	800	
Bad debts written off	558	
Share premium		6,000
Fees and commission income		1,528
Dividend income		816
Investment in securities	10,920	
Miscellaneous accruals		280
Government securities	26,400	
Retained earnings (1 April 2015)		4,960
Other assets	10,600	
	263,150	263,150

Additional information:

1. Analysis of debtors balances at the end of the year revealed that an additional provision of Sh3,700,000 for non performing loans should be made.
2. A provision of Sh.2,100,000 should be made for tax on the profit for the year ended 31 March 2016.
3. Interest accrued and not accounted for in the books as at 31 March 2016 was as follows:

	Sh."000"
Interest on loans and advances	1,284
Interest on customers deposits	896

4. Directors of the bank have proposed a final dividend at a rate of 5%.

Required:

Prepare for Maendeleo Bank Ltd.:

(i) Income statement for the year ended 31 March 2016. (8 marks)

(ii) Statement of financial position as at 31 March 2016. (6 marks)

(Total: 20 marks)

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