kasneb

CPA PART II SECTION 3

FINANCIAL REPORTING

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

The following trial balance was extracted from the books of Sombea Ltd. as at 31 March 2019:

	Sh."000"	Sh."000"
Land and buildings at valuation (1 April 2018)	468,000	
Plant at cost	460,800	
Accumulated depreciation (1 April 2018)		115,200
Available for sale investments	95,400	
Investment income		7,920
Cost of sales	321,120	
Distribution costs	39,600	
Administrative expenses	45,000	
Debenture interest paid	2,880	
Inventory (31 March 2019)	136,440	
Income tax liability		41,760
Trade receivables	126,360	
Revenue		649,440
Ordinary shares of Sh.50 (at par value)		216,000
Retained earnings (1 April 2018)		91,800
4% debentures		288,000
Trade payables		124,920
Revaluation surplus (Land and buildings)		50,400
Suspense account		86,400
Bank		23,760
	1,695,600	1,695,600

Additional information:

1. The 4% debentures were issued on 1 October 2018 under terms that provided for a large premium on redemption in year 2021. The finance officer has calculated that the effect of this is that the debenture has an effective interest rate of 6% per annum.
2. A provision of Sh.61,560,000 should be made for tax on the profit for the year ended 31 March 2019.
3. The suspense account contains the corresponding credit entry for the proceeds of a rights issue of shares made on 1 January 2019. The terms of the issue were one share for every four shares held at Sh.80 per share. Sombea Ltd.'s share price immediately before the issue was Sh.100. The issue was fully subscribed.
4. The fair value of available for sale investments as at 31 March 2019 was Sh.97,560,000.
5. Sombea Ltd. has a policy of revaluing its land and buildings at each year end. The valuation in the trial balance includes land element of Sh.108,000,000. The estimated remaining life of the buildings as at that date (1 April 2018) was 20 years. On 31 March 2019, a professional valuer valued the buildings at Sh.331,200,000 with no change in the value of the land. Depreciation on buildings is charged 60% to cost of sales and 20% each to distribution costs and administrative expenses.
6. During the year, Sombea Ltd. manufactured an item of plant which it was using as part of its own operating capacity. The details of the plant's cost which is included in the cost of sales in the trial balance, are:

	"Sh.000"
Material cost	21,600
Direct labour cost	14,400
Machine time cost	28,800
Directly attributable overheads	21,600

The manufacture of the plant was completed on 30 September 2018 and the plant was brought into immediate use, but its cost has not yet been capitalised. All plant is depreciated at a rate of 12.5% per annum (time apportioned where relevant) using the reducing balance method and charged to cost of sales. No non-current assets were sold during the year.

Required:

(a) Statement of comprehensive income for the year ended 31 March 2019. (8 marks)

(b) Statement of financial position as at 31 March 2019. (12 marks)

(Total: 20 marks)

QUESTION TWO

Fanaka Ltd. acquired 90% of the ordinary shares of Sh.10 par value in Mali Ltd. on 1 January 2015 when Mali Ltd. had revenue reserves of Sh.1,500 million.

Mali Ltd. acquired 160 million ordinary shares of Sh.10 par value in Kwetu Ltd. on 1 January 2016 when Kwetu Ltd. had revenue reserves of Sh.500 million.

The financial statements of the three companies for the year ended 31 December 2018 are provided below.

Income statement

	Fanaka Ltd. Sh."million"	Mali Ltd. Sh."million"	Kwetu Ltd. Sh."million"
Revenue	7,200	4,700	2,450
Cost of sales	(5,400)	(3,760)	(1,715)
Gross profit	1,800	940	735
Investment income	218	40	-
	2,018	980	735
Operating expenses	(740)	(390)	(295)
Profit before tax	1,278	590	440
Income tax expense	(420)	(230)	(176)
Profit after tax	858	360	264
Dividend - Paid	(200)	(120)	(100)
- Proposed	(300)	(120)	(100)
Retained profit	358	120	64

Statements of financial position as at December 2018:

	Fanaka Ltd. Sh."million"	Mali Ltd. Sh."million"	Kwetu Ltd. Sh."million"
Non-current assets:			
Property, plant and equipment	15,500	9,700	6,500
Goodwill	-	-	500
Investment in - Mali Ltd.	8,400	-	-
- Kwetu Ltd.	-	3,500	-
Current assets	4,400	2,800	1,700
	28,300	16,000	8,700
Equity and liabilities:			
Ordinary share capital	10,000	6,000	4,000
Share premium	4,000	2,500	2,500
Revenue reserves	3,800	2,720	1,354
	17,800	11,220	7,854
Non-current liabilities:			
Bank loan	8,000	3,000	-
Current liabilities	2,500	1,780	846
	10,500	4,780	846
	28,300	16,000	8,700

Additional information:

1. On 31 December 2017, Mali Ltd. held stock bought from Fanaka Ltd. for Sh.120 million and on which Fanaka Ltd. had made a profit of $33^1/_3$% on cost.
2. In the year ended 31 December 2018, Fanaka Ltd. made sales of Sh.400 million to Mali Ltd. at a profit of 20% on selling price. One quarter of the goods purchased by Mali Ltd. from Fanaka Ltd. in the year remained unsold as at 31 December 2018.

3. All the three companies paid the interim dividend on 15 June 2018. No company has accrued its share of proposed dividend from either its subsidiary or associate company.
4. The inter-company outstanding balances as a result of trading were as follows:
   - Due from Fanaka Ltd. to Mali Ltd. Sh.45 million.
   - Due from Mali Ltd. to Kwetu Ltd. Sh.20 million.
5. Any goodwill on acquisition of the subsidiary or associate is considered impaired by 20%.
6. Fair value of tangible assets were not materially different from their book values on the date Fanaka Ltd. acquired its control in Mali Ltd. and on the date Mali Ltd. acquired its holding in Kwetu Ltd.

Required:

(a) Consolidated income statement for the year ended 31 December 2018. (8 marks)

(b) Consolidated statement of changes in equity. (2 marks)

(c) Consolidated statement of financial position as at 31 December 2018. (10 marks)

(Total: 20 marks)

QUESTION THREE

(a) Describe the two types of post-employment benefit plans in accordance with International Accounting Standard (IAS) 19 "Employee Benefits". (6 marks)

(b) Exe, Wye and Zed have been partners for several years in a partnership business under the name, Eweza Holdings. Due to successive trading losses that the business has been posting in recent years, the partners agreed to dissolve their business with effect from 1 July 2018.

The latest statement of financial position of the firm as at 30 June 2018 showed:

		Sh. "000"
Non-current assets:	Land and building	18,400
	Motor vehicles	8,200
	Furniture and fixtures	3,100
	Investment in shares	4,600
		34,300
Current Assets:	Inventories	4,750
	Trade receivables	3,200
Total assets		42,250
Capital and liabilities:		
Capital accounts:	Exe	14,400
	Wye	7,200
	Zed	3,600
Current accounts:	Exe	2,700
	Wye	1,900
	Zed	600
Loan from a Sacco		4,000
Current liabilities:	Trade payables	6,400
	Bank overdraft	1,450
		42,250

Additional information:

1. The partners shared profits and losses in the ratio of 2:2:1 for Exe, Wye and Zed respectively.
2. Partner Wye agreed to settle the unsecured loan from the Sacco while Zed took over some of the inventory valued at Sh.2 million.
3. The trade payables accepted Sh.5.8 million in full settlement of the amounts due to them.
4. The assets of the partnership were auctioned and realised in stages on piece-meal basis as follows:

Date	Assets realised	Amount Sh."000"
20 July 2018:	Trade receivables (part)	2,200
	Inventory (part)	1,750
	Investment in shares	4,400
	Motor vehicles (part)	7,000
31 July 2018:	Trade receivables (balance)	1,000
	Furniture and fixtures	2,900
25 August 2018:	Inventory (balance)	700
	Motor vehicles (balance)	2,000
10 September 2018:	Land and building	18,000

5. The auctioneers fees were agreed at Sh.3.5 million and were to be paid upfront immediately there was an available bank balance.
6. The rule in Garner vs. Murray applies where necessary.

Required:

(i) A schedule of payments to the partners using the maximum possible loss method. (8 marks)

(ii) Realisation account. (3 marks)

(iii) Partners capital accounts. (3 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Distinguish between the following terminologies as used in construction contracts:

(i) "Lumpsum contract" and "percentage rate contract". (4 marks)

(ii) "Indemnity clause" and "retention clause". (4 marks)

(b) Discuss two methods of determining the stage of completion of a construction contract. (4 marks)

(c) Mijengo Construction Ltd. carried out work on four construction contracts during the financial year ended 30 April 2019.

The details of the contracts are set out below:

	AO1	**BO2**	**CO3**	**DO4**
	Sh."million"	**Sh."million"**	**Sh."million"**	**Sh."million"**
Contract price	780	1,200	1,020	948
Costs to date	180	480	963.6	33.6
Estimated total cost	720	768	1,069.2	840
Payment on account	156	780	918	24
Revenue recognised in previous periods	78	180	504	-
Cost recognised in previous periods	60	72	480	-
Administrative expenses	1.5	15	2.5	-
Date of commencement	1 May 2017	1 February 2017	1 March 2017	1 March 2019

Additional information:

1. The company does not recognise profits until the contract is at least 5% complete.
2. The company's policy is to calculate the percentage of completion on cost basis.
3. The company prepares separate trading accounts for each contract.

Required:

(i) Trading account for each of the contracts showing clearly the revenue to be recognised for the year ended 30 April 2019. (3 marks)

(ii) An income statement extract for the year ended 30 April 2019. (3 marks)

(iii) An extract of the statement of financial position showing the combined totals for all the contracts. (2 marks)

(Total: 20 marks)

QUESTION FIVE

(a) In the context of International Accounting Standard (IAS) 16 "Property, Plant and Equipment", explain four disclosure requirements for items of property, plant and equipment which are stated at revalued amounts. (8 marks)

(b) Baraka Ltd. is a manufacturing firm with its head office in Kisumu, Kenya and a branch in Entebbe, Uganda. The branch carries out the final assembly of the products before selling them. The currency in Kenya is the Kenya shilling (Ksh.) while the currency in Uganda is the Uganda shilling (Ush.). The trial balances for both the head office and the branch in their respective currencies as at 31 March 2019 were as follows:

	Head office (Ksh.)		Branch (Ush.)	
	Sh."000"	Sh."000"	Sh."000"	Sh."000"
Sales		416,000		1,728,000
Freehold building at cost	56,000		252,000	
Trade receivables and trade payables	35,600	38,000	144,000	6,240
Share capital		160,000		
Goods sent to branch		140,000		
Head office/Branch account	240,400			2,017,040
Cost of sales (branch)			1,440,000	
Provision for depreciation on machinery		6,000		226,800
Head office cost of sales (including goods sent to branch)	236,000			
Administrative cost	60,800		72,000	
Inventory - 31 March 2019	115,600		46,080	
Profit and loss account - 1 April 2018		8,000		
Machinery at cost	24,000		504,000	
Remittances		112,000	1,088,000	
Bank balance	18,400		316,800	
Selling and distribution costs	93,200		115,200	
	880,000	880,000	3,978,080	3,978,080

Additional information:

1. The branch remitted Ush.64,000,000 on 30 March 2019 which was not received by the head office until 3 April 2019. The amount realised was Ksh.7,960,000.
2. In the month of February 2019, a customer of the branch paid the head office for goods supplied by the branch. The amount due from him was Ush.1,280,000 which realised Ksh.144,000. It has been correctly dealt with by the head office but not yet entered in the branch accounts.
3. Commission which is payable to the branch manager, is to be provided at a rate of 5% of the net profits of the branch after charging such commission.
4. The cost of sales figure includes a depreciation charge of 10% par annum on the cost of machinery.
5. A provision of Ksh.1,200,000 for unrealised profit in the branch inventory is to be made.
6. The relevant exchange rates were as follows:

	Ksh.	To	Ush.
On 1 April 2018	1		20
On 31 March 2019	1		16
Average rate for the year ended 31 March 2019	1		18
On date of purchase of freehold building and machinery	1		14

Required:

(i) Branch trial balance (after the necessary adjustments) in Kenya shillings. (4 marks)

(ii) Income statement for the head office, the branch and the combined business for the year ended 31 March 2019. (4 marks)

(iii) Combined statement of financial position as at 31 March 2019 (ignore the effects of taxation). (4 marks)

(Total: 20 marks)

....