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CPA PART II SECTION 3

FINANCIAL REPORTING

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) The objective of International Accounting Standard (IAS) 2 "Inventories" is to prescribe the accounting treatment for inventories. IAS 2 provides useful guidance particularly in economies which are dependent on agriculture.

Required:

Summarise the key requirements of IAS 2 under the following headings:

(i) Scope of the term "inventories". (2 marks)

(ii) Measurement of inventories. (3 marks)

(iii) Disclosure requirements. (4 marks)

(b) The following trial balance relates to Marine Insurance Company Ltd. for the year ended 30 June 2018:

	Sh."000"		Sh."000"
Ordinary shares of Sh.10 each			50,000
9% cumulative preference shares			20,000
Statutory reserve			4,200
Retained earnings			15,800
Freehold land	18,000		
Building: Cost	60,000		
Accumulated depreciation			5,000
Equipment: Cost	60,000		
Accumulated depreciation			13,000
Government securities	28,500		
Investment in shares	12,500		
Claims paid	28,400		
Gross premiums earned			86,000
Re-insurance premiums ceded	10,700		
Legal expenses	3,800		
Commissions earned			450
Commissions payable	700		
Unearned premiums			47,500
Operating expenses	14,250		
Accrued preference dividends payable			5,400
Fees received			4,400
Repairs and maintenance	8,500		
Trade receivables	15,350		
Trade payables			8,500
Investment income			1,800
Claims outstanding			4,100
Bank balances		3,900	
Receivables arising out of re-insurance arrangements	1,550		
	266,150		266,150

Additional information:

1. The freehold land was revalued upwards by Sh.2 million but the revaluation had not been incorporated in the accounts.
2. Dividends on preference shares were in arrears for four years. The board has decided to pay the dividends for only three years.

3. Depreciation is to be charged per annum using the straight line method as follows:

Asset	Rate per annum
Building	2%
Equipment	15%

4. Claims amounting to Sh.2,850,000 were estimated to be outstanding as at 30 June 2018.
5. Current year's estimated tax is Sh.5,000,000.
6. Out of the total legal expenses incurred in the year ended 30 June 2018, Sh.2,450,000 was on claims paid.
7. The directors have recommended a first and final dividend of 20% on ordinary shares.

Required:

(i) Statement of comprehensive income for the year ended 30 June 2018. (6 marks)

(ii) Statement of financial position as at 30 June 2018. (5 marks)

(Total: 20 marks)

QUESTION TWO

Safina Ltd., a manufacturing company, presented the following trial balance as at 31 October 2018:

	Sh."000"	Sh."000"
Revenue		8,700
Purchases	1,500	
Production cost	1,200	
Administrative expenses	980	
Distribution cost	370	
Interest on loan	50	
Research and development	470	
Land and buildings at valuation (1 November 2017)	1,700	
Equipment at cost	4,500	
Investment property at valuation (1 November 2017)	2,200	
Accumulated depreciation (1 November 2017):		
Buildings		400
Equipment		450
Intangible asset at cost	500	
Accumulated amortisation (1 November 2017)		50
Inventory (1 November 2017)	50	
Bank balances	400	
Trade receivables	350	
10% bank loan		1,000
Interim dividend paid	350	
Trade payables		400
Corporation tax		35
Ordinary share capital		1,250
Share premium		250
Revaluation reserve (1 November 2017)		300
Retained earnings (1 November 2017)		1,785
	14,620	14,620

Additional information:

1. Included in the revenue is a government grant of Sh.150,000 that Safina Ltd. received. The grant relates to the employment of additional staff that is expected during the next financial year.
2. Research and development expenditure comprises the following:
   - Sh.80,000 on general research.
   - Sh.67,000 on developing new technology. At the year end, the directors do not think that the development will be successful.
   - Sh.323,000 on development of new production technology. The development is almost complete and the directors are highly confident that the technology will result in significant cost savings.
3. Intangible asset at cost relates to a development that was being amortised over a useful life of 10 years. As at 1 November 2017, this was reviewed and the development was then assessed as having a remaining useful life of six years.
4. The Sh.1,700,000 relating to land and buildings is based on last year's revaluation and includes land at a valuation of Sh.1,000,000. Land has an indefinite useful life. The buildings should be depreciated on the value at the start of the year and the remaining useful life was 20 years as at 1 November 2017.
5. As at the year end, the directors obtained the following valuations:
   - Land Sh.1,250,000
   - Buildings Sh.570,000

6. Equipment is depreciated on a straight line basis over 5 years. Safina Ltd. estimates that the equipment is used in the business on the following basis:
   - 50% in production
   - 25% in the administration functions
   - 25% in distribution functions
7. The year end valuation of the investment property was Sh.2,500,000 and Safina Ltd.'s accounting policy is to use the fair value model for investment properties.
8. The year end inventory was valued at Sh.65,000 but it was subsequently discovered that goods included within this value with a cost of Sh.7,000 were sold for Sh.2,000.
9. Safina Ltd. took out the bank loan of Sh.1,000,000 on 1 November 2017 which is repayable in four equal annual instalments. The interest rate on the loan is 10% per annum payable semi-annually.
10. The corporation tax for the previous year was settled in July 2018 and the estimate for corporation tax for the year ended 31 October 2018 is Sh.625,000.
11. The directors have also discovered that a customer who owed Sh.125,000 as at the year end was declared bankrupt.

Required:

(a) A statement of comprehensive income for the year ended 31 October 2018. (10 marks)

(b) A statement of financial position as at 31 October 2018. (10 marks)

(Total: 20 marks)

QUESTION THREE

(a) International Financial Reporting Standard (IFRS) 9 "Financial Instruments" establishes principles of derecognising financial assets and financial liabilities. Derecognition is the removal of a previously recognised financial instrument from an entity's statement of financial position.

Required:

With reference to the principles of IFRS 9, describe the criteria for derecognition of financial assets and financial liabilities of an entity. (6 marks)

(b) The following financial statements relate to Sasumua Ltd. and its investment companies for the year ended 30 September 2018:

Consolidated statement of comprehensive income for the year ended 30 September 2018:

	Sh."million"
Revenue	4,805
Cost of sales	(3,844)
Gross profit	961
Other income	21
Selling and distribution costs	(283)
Administrative expenses	(304)
Finance costs	(85)
Share of profit of joint venture	85
Profit before tax	395
Income tax expense	(80)
Profit for the year	315
Other comprehensive income:	
Revaluation gain on property, plant and equipment (net of deferred tax)	105
Total comprehensive income	420
Profit for the year:	
Attributable to the owners of the parent	290
Attributable to the non-controlling interests	25
	315

Consolidated statement of financial position as at 30 September:

	2018	2017
Assets:	Sh."million"	Sh."million"
Non-current assets:		
Property, plant and equipment	2,831	2,345
Interest in joint venture	427	380
Goodwill on acquisition	432	455
	3,690	3,180
Current assets:		
Inventory	170	128
Accounts receivable	238	214
Cash and cash equivalents	78	63
	486	405
Total assets	4,176	3,585

	Sh."million"	Sh."million"
Equity and liabilities:		
Equity:		
Ordinary share capital	1,320	1,000
Share premium	460	400
Revaluation surplus	284	200
Retained profit	570	360
Owner's equity	2,634	1,960
Non-controlling interests	186	180
	2,820	2,140
Non-current liabilities:		
10% convertible loan stock	780	960
Deferred tax	150	185
Current liabilities:		
Accounts payable	234	175
Current tax	92	94
Interest payable	100	31
Total equity and liabilities	4,176	3,585

Consolidated statement of changes in equity for the year ended 30 September 2018

	Ordinary share capital Sh."million"	Share premium Sh."million"	Revaluation surplus Sh."million"	Retained profit Sh."million"	Total Sh."million"
As at 1 October 2017	1,000	400	200	360	1,960
New share issue	320	60			380
Revaluation of property, plant and equipment			84		84
Profit for the year				290	290
Dividend paid				(80)	(80)
As at 30 September 2018	1,320	460	284	570	2,634

Additional information:

1. The property, plant and equipment account comprised the following:

	30 September 2018 Sh."million"	30 September 2017 Sh."million"
Cost	3,765	2,970
Accumulated depreciation	(934)	(625)
Carrying amount	2,831	2,345

During the year ended 30 September 2018, an 80% owned subsidiary revalued its property upwards by Sh.150 million. The holding company disposed of an item of plant which had cost Sh.290 million and had accumulated depreciation of Sh.96 million. The disposal proceeds amounted to Sh.215 million.

2. The 10% convertible loan stock was convertible at any time at the holders' option into 20 ordinary shares of Sh.10 each for every Sh.200 of the loan stock. During the year ended 30 September 2018, holders of Sh.180 million of 10% convertible loan stock exercised their conversion option.
3. Impairment loss on goodwill and depreciation for the year ended 30 September 2018 have been charged to profit or loss for the year.
4. Assume a corporation tax rate of 30%.

Required:

Consolidated statement of cash flows for the year ended 30 September 2018 using the indirect method in conformity with the requirements of International Accounting Standard (IAS) 7 "Statement of Cash Flows". (14 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Miaka Nenda Ltd.'s current year end is 30 June 2018. The company's financial statements were authorised for issue by its directors on 10 July 2018.

The following matters have been brought to your attention:

1. On 11 July 2018, a fire completely destroyed the company's largest warehouse and the inventory it contained. The carrying amounts of the warehouse and the inventory were Sh.80,000,000 and Sh.50,000,000 respectively. It appears that the company has not updated the value of its insurance cover and only expects to be able to recover a maximum of Sh.70,000,000 from its insurers. Miaka Nenda Ltd's trading operations have been severely disrupted since the fire and it expects significant trading losses for some time to come.
2. A single class of inventory held at another warehouse was valued at its cost of Sh.9,200,000 as at 30 June 2018. In July 2018, 70% of this inventory was sold for Sh.5,600,000 on which the company's staff earned a commission of 15% of the selling price.
3. On 10 August 2018, the government announced tax changes which had the effect of increasing the company's deferred tax liability by Sh.7,000,000 as at 30 June 2018.

Required:

With reference to International Accounting Standard (IAS) 10 "Events After the Balance Sheet Date", explain the required treatment of each of the above items in the financial statements of Miaka Nenda Ltd. for the year ended 30 June 2018. (6 marks)

(b) A, B and C have been in partnership sharing profits and losses in the ratio of 2:2:1 respectively. Their financial year end is 30 September. A decided to quit the partnership with effect from 10 May 2018. The remaining two partners, B and C, decided to dissolve the partnership from that date. The terms of dissolution were that the assets were to be realised, outstanding debts paid and the remainder to be shared by the partners. A was to be paid in an equitable manner, distribution of cash being made as soon as possible.

The following is the statement of financial position of the partnership as at 10 May 2018:

A, B and C
Statement of financial position as at 10 May 2018

		Sh."000"	Sh."000"
Assets:			
Non-current assets (net book value):			
Land and building			182,000
Plant and machinery			73,600
Fixtures and fittings			20,800
Motor vehicle			7,200
Intangible asset (goodwill)			89,200
			372,800
Current assets:			
Inventory		68,000	
Trade receivables		62,000	
Bank balance		9,200	
Cash balance		3,200	142,400
			515,200
Capital and liabilities:			
Capital accounts:	A		100,000
	B		64,000
	C		40,000
			204,000
Current accounts:	A	32,000	
	B	22,000	54,000
			258,000
Long-term liability:			
Bank loan			160,000
Current liabilities:			
Trade payables		33,200	
Bank overdraft		64,000	97,200
			515,200

Additional information:

1. The partnership had an insurance policy which entitled the firm to Sh.40,000,000 immediately a partner left.
2. Dissolution expenses amounted to Sh.1,800,000 and were paid on 30 August 2018.
3. As soon as sufficient money was available, all the outstanding payables were paid after the discount received which amounted to Sh.1,000,000.

4. Assets were sold and the monies received on piecemeal basis as follows:

Date	Particulars	Amount Sh."000"
30 May 2018:	Insurance policy	40,000
	Insurance benefit received (interest)	16,000
	Land and building	180,000
25 June 2018:	Plant and machinery	41,200
	Trade receivables	26,000
20 July 2018:	Motor vehicle	6,400
	Fixtures and fittings	8,800
15 August 2018:	Plant and machinery	32,400
	Fixtures and fittings	8,000
20 September 2018:	Inventory	68,000
	Trade receivables	40,000

Required:

(i) Statement showing how the proceeds of the dissolution will be shared between the partners. (8 marks)

(ii) Realisation account. (3 marks)

(iii) Partners' capital accounts. (3 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Citing relevant examples, summarise the accounting treatment of government grants received by an entity. (6 marks)

(b) The following trial balance was extracted from the books of DD Associates, a firm of advocates, as at 30 September 2018:

	Sh."000"	Sh."000"
Costs charged to clients on:		
Civil cases		4,250
Criminal cases		2,450
Oaths		260
Conveyance fees		340
Preparation of wills		200
Cases in progress as at 1 October 2017	1,104	
Clients account (money held on behalf of clients)		744
Accounts payable		816
Accounts receivable	2,440	
General office expenses	255	
Furniture, fittings and library books	1,350	
Cash at bank: Clients' account	744	
Office	1,671	
Capital		6,220
Disbursements on behalf of clients	360	
Drawings	1,800	
Salaries to office staff	2,160	
Rent and rates	1,800	
Postage and telephone	546	
Printing and stationery	1,050	
	15,280	15,280

Additional information:

1. It is estimated that debts amounting to Sh.165,000 might not be collected and should be written off.
2. Depreciation should be provided at the rate of 20% per annum on the book value of furniture, fittings and library books.
3. Cases in progress as at 30 September 2018 were valued at Sh.705,000.

Required:

(i) Statement of comprehensive income for the year ended 30 September 2018. (8 marks)

(ii) Statement of financial position as at 30 September 2018. (6 marks)

(Total: 20 marks)

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