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CPA PART II SECTION 3

FINANCIAL REPORTING

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) Citing two examples, explain the accounting treatment of contingent assets. (4 marks)

(b) With reference to International Accounting Standard (IAS) – 16: Property, Plant and Equipment:

(i) Describe two conditions under which property, plant and equipment should be recognised. (4 marks)

(ii) Outline the provisions with regard to derecognition of property, plant and equipment. (4 marks)

(c) The objective of IFRS 15 – Revenue from Contracts with Customers, is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue from a contract with a customer.

In context of the above statement:

(i) Discuss how contracts with customers will be presented in the financial statements in line with IFRS 15 requirements. (4 marks)

(ii) Summarise the disclosure requirements under IFRS 15. (4 marks)

(Total: 20 marks)

QUESTION TWO

The following trial balance relates to Tamutamu Ltd. as at 30 September 2019:

	Sh."000"	Sh."000"
Revenue		68,865
Inventory	3,150	
Cost of sales	35,500	
Selling and distribution expenses	5,600	
Administrative expenses	8,540	
Interest on loan note	110	
Investment income		360
Bank interest	85	
Leasehold building at valuation (1 October 2018)	14,000	
Plant and equipment – cost/depreciation	13,750	3,200
Computer equipment – cost/depreciation	7,200	2,000
Motor vehicles – cost/depreciation	1,500	400
Available for sale investments	8,700	
Trade receivables	9,200	
Bank balance		910
Trade payables		3,400
Deferred tax (1 October 2018)		2,300
Ordinary shares of Sh.29 each		14,500
8% loan note (2017 – 2021)		2,500
10% preference shares (redeemable)		3,000

	Sh."000"	Sh."000"
Revaluation surplus		800
General reserve		1,500
Retained earnings (1 October 2018)		3,600
	107,335	107,335

Additional information:

1. On 31 March 2019, the company made a bonus issue from retained earnings of one new share for every four shares in issue at Sh.10 each. This transaction is yet to be recorded in the books.

   The company paid ordinary dividends of Sh.2.20 per share on 31 January 2019 and Sh.2.60 per share on 30 June 2019. The dividend payments are included in administrative expenses in the trial balance.
2. Interest on loan notes and dividend on preference shares have not yet been accounted for.
3. Revenue includes Sh.8 million for credit sales made on a "sale or return basis". As at 30 September 2019, customers who had not paid for the goods, had the right to return Sh.2.6 million of them. Tamutamu Industries Ltd. applied a mark up of 30% on all sales. In the past, the company's customers have sometimes returned goods under this type of agreement.
4. Depreciation on property, plant and equipment is to be provided on the following basis; Plant and equipment – 10% on cost charged to cost of sales, computer equipment – 25% on cost charged to administrative expenses, motor vehicles – 20% on reducing balance charged to selling and distribution expenses.
5. Tamutamu Ltd. revalues its building at the end of each accounting year. At 30 September 2019, the relevant value to be incorporated into the financial statements was Sh.14,100,000.

   The building's remaining useful life at the beginning of the current year (1 October 2018) was 25 years. Tamutamu Ltd. does not make an annual transfer from the revaluation reserve to retained earnings in respect of the realisation of the revaluation surplus.

   Depreciation on building is an administrative expense. Ignore deferred tax on the revaluation surplus.
6. The available for sale investments held at 30 September 2019 had a fair value of Sh.8,400,000. There were no acquisitions or disposals of these investments during the year.
7. In February 2019, Tamutamu Ltd.'s internal audit unit discovered a fraud committed by the company's credit manager who did not return from a foreign business trip. The outcome of the fraud is that Sh.500,000 of the company's trade receivables have been stolen and are not recoverable. Of this amount, Sh.200,000 relates to the year ended 30 September 2018 and the remainder to the current year.
   Tamutamu Ltd. is not insured against this fraud.
8. Income tax payable on the profit for the year ended 30 September 2019 is estimated to be Sh.3,500,000. An amount of Sh.1,200,000 is to be transferred to the deferred tax account.

Required:

(a) A statement of comprehensive income for the year ended 30 September 2019. (10 marks)

(b) A statement of changes in equity for the year ended 30 September 2019. (2 marks)

(c) A statement of financial position as at 30 September 2019. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) With regard to International Public Sector Accounting Standard (IPSAS) 29 "Financial Instruments: Recognition and Measurement", describe the subsequent measurement of financial assets held by a public sector entity, indicating how this measurement differs from the requirements of International Financial Reporting Standard (IFRS) 9 "Financial Instruments: Recognition and measurement". (6 marks)

(b) The following are the draft statements of financial position of Aby Limited and Benta Limited as at 30 April 2020:

	Aby Limited Sh."million"	Benta Limited Sh."million"
Assets:		
Non-current assets:		
Property, plant and equipment	25,290	5,420
Investments	8,120	NIL
	33,410	5,420
Current assets:		
Inventory	2,750	1,295
Trade receivables	2,135	1,010

	Sh."million"	Sh."million"
Cash and bank balances	1,220	575
Total assets	39,515	8,300
Equity and liabilities:		
Equity:		
Ordinary shares of Sh.10 each	12,500	3,800
Revaluation surplus	2,700	260
Retained profit	13,600	2,350
	28,800	6,410
Non-current liabilities:		
Deferred consideration	1,800	NIL
10% debentures	2,450	500
Deferred tax	1,920	375
Current liabilities:		
Trade payables	3,200	655
Current tax	1,345	360
Total equity and liabilities	39,515	8,300

Additional information:

1. On 1 May 2019, Aby Limited acquired 80% of the share capital of Benta Limited. At this date, the retained profit of Benta Limited amounted to Sh.2,200 million and the revaluation surplus stood at Sh.260 million. Aby Limited paid an initial cash consideration of Sh.5,940 million and agreed to pay the owners of Benta Limited a further Sh.1,800 million on 1 May 2021. The accountant of Aby Limited has recorded the full amounts of both elements of the consideration in investments. Aby Limited has a cost of capital of 8% and the appropriated discount factor is 0.857.
2. On 1 May 2019, the fair values of Benta Limited's net assets were equal to their carrying amounts with the exception of some inventory which had cost Sh.193 million but had a fair value of Sh.233 million. On 30 April 2020, 10% of these goods remained in the inventory of Benta Limited.
3. During the year, Aby Limited sold goods worth Sh.515 million to Benta Limited at a profit mark up of 25% above the cost. At 30 April 2020, Benta Limited still held Sh.75 million of these goods in its inventory.
4. On 1 May 2019, Aby Limited also acquired an investment of 30% of the ordinary shares in Ceda Limited which cost Sh.380 million. Ceda Limited reported a profit of Sh.850 million during the year ended 30 April 2020.
5. Aby Limited has a policy of valuing non-controlling interests at fair value. On 1 May 2019, the non-controlling interest in Benta Limited had a fair value of Sh.1,317 million.
6. Impairment tests carried out on 30 April 2020 concluded that the value of the investment in Ceda Limited was impaired by Sh.85 million while the consolidated goodwill was impaired by Sh.100 million.

Required:

(i) Calculate the carrying amount of the investment in Ceda Limited to be included within the consolidated statement of financial position using the equity method. (2 marks)

(ii) The consolidated statement of financial position for the Aby Group as at 30 April 2020. (12 marks)

(Total: 20 marks)

QUESTION FOUR

Mika and Nira had been operating as sole traders. On 30 September 2018, they amalgamated and traded as partners under the name Minira Traders sharing profits and losses in the ratio of 4:1 respectively. One year later on 30 September 2019, they converted the partnership into a limited liability company trading as MN Ltd.

No adjustments have been made to record the amalgamation and conversion but the statements of financial position for the sole traders as at 30 September 2018 and the partnership as at 30 September 2019 were as follows:

	Sole Traders Statement of financial position as at 30 September 2018		Minira Traders Statement of financial position as at 30 September 2019
	Mika	Nira	
Assets:	Sh."000"	Sh."000"	Sh."000"
Freehold property	3,000	2,000	8,000
Plant and equipment	13,600	11,200	26,000
Fixtures and fittings	3,200	3,100	6,000
Inventory	3,600	700	6,700

	Sh."000"	Sh."000"	Sh."000"
Accounts receivable	3,800	2,000	12,840
Balance at bank	600	300	250
	27,800	19,300	59,790
Liabilities:			
Accounts payable	(13,600)	(8,000)	(19,840)
Bank overdraft	-	-	(11,250)
	14,200	11,300	28,700

Additional information:

1. On 1 October 2018, the partners agreed to take up the assets and liabilities of the individual traders at book values except for freehold property, plant and equipment and fixtures and fittings which were to be revalued as follows:

	Mika Sh."000"	Nira Sh."000"
Freehold property	4,000	3,000
Plant and equipment	13,000	11,000
Fixtures and fittings	3,000	3,000

2. During the year ended 30 September 2019, Mika made drawings of Sh.4,780,000 while Nira drew Sh.1,220,000.
3. The partnership was converted into a limited company, MN Ltd., on the following terms:
   (i) The freehold property and accounts receivable were revalued to Sh.12,000,000 and Sh.11,340,000 respectively.
   (ii) Mika and Nira were to receive 15% unsecured debentures at par so as to provide each partner with income equivalent to a 6% return on capital employed based on capital balances as at 30 September 2019 (that is after accounting for the profits, drawings and revaluation in note (i) above).
   (iii) MN Ltd.'s authorised share capital was made up of 150,000 ordinary shares of Sh.100 each out of which 130,000 shares were to be issued to the partners in their profit sharing ratio.
   (iv) Any balances in the partners' capital accounts were to be settled in cash.

Required:

(a) A computation showing the value of debentures and ordinary shares to be issued to the partners. (12 marks)

(b) Partners capital accounts as at 30 September 2019. (3 marks)

(c) Statement of financial position of MN Ltd. as at 30 September 2019. (5 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The following trial balance was extracted from the books of David Wekesa, a farmer as at 31 October 2019:

		Sh."000"	Sh."000"
Inventory (1 November 2018):	Dairy cattle	54,900	
	Maize (growing)	3,600	
	Dairy cattle feeds	2,520	
	Fertilisers (for maize)	1,980	
Land and buildings		90,000	
Tractors (net book value)		32,400	
Other cattle (bulls)		6,000	
Carts (net book value)		3,000	
Purchases:	Dairy cattle	10,440	
	Fertilizers (for maize)	2,160	
	(for napier grass)	4,000	
	Maize seeds	1,080	
	Dairy cattle feeds	6,120	
Sales:	Milk		27,360
	Dry maize		36,000
	Green maize		11,340
	Dairy cattle		8,100
	Manure		3,000
Crop expenses:	Labour	6,480	
	Other expenses	720	
Napier grass (labour)		1,000	
General expenses		10,800	

		Sh."000"	Sh."000"
Trade payables			15,620
Capital (1 November 2018)			163,080
Cash at bank		15,300	
Dairy cattle expenses:	Medicine	1,080	
	Labour	9,480	
	Other expenses	1,440	
		264,500	264,500

Additional information:

1. Inventories as at 31 October 2019 were valued as follows:

	Sh."000"
Dairy cattle	54,000
Maize (growing)	2,700
Other cattle (bulls)	5,400
Dairy cattle feeds	1,620
Fertilizers for planting maize	1,080

2. During the financial year ended 31 October 2019, the following distributions of farm produce were made:

Product	Value Sh."000"
Maize consumed by family members	1,080
Milk delivered to relative's hotel	4,320
	5,400

3. Manure valued at Sh.600,000 was removed from the cow shed and used in the maize plantation.
4. Maize stocks valued at Sh.1,500,000 were used as dairy cattle feed.
5. Cattle bulls are used for pulling carts.
6. Depreciation is to be provided on tractors and carts on the reducing balance method at the rate of 25% and 12% per annum respectively.
7. Income tax is estimated at Sh.3,600,000.

Required:

(i) Revenue accounts for the year ended 31 October 2019. (6 marks)

(ii) Income statement for the year ended 31 October 2019. (3 marks)

(iii) Statement of financial position as at 31 October 2019. (3 marks)

(b) In the co-operative sector, a standardised accounting system is the use of similar accounting procedures in recording transactions. It means that similar documents and books of account are used in all societies of the same type.

Required:

Discuss four objectives of a standardised accounting system for co-operative societies. (8 marks)

(Total: 20 marks)

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