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CPA PART II SECTION 3

FINANCIAL REPORTING

THURSDAY: 30 November 2017. 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) In the context of International Public Sector Accounting Standard (IPSAS) 3 – Accounting Policies, Changes in Accounting Estimates and Errors:

(i) Explain the meaning of "prior period errors", citing two examples of such errors. (4 marks)

(ii) Summarise the accounting treatment of material prior period errors. (4 marks)

(b) IPSAS 8 – Financial Reporting of Interests in Joint Ventures identifies three forms of joint ventures:

Required:

(i) Highlight the three forms of joint ventures referred to above. (6 marks)

(ii) Describe the accounting treatment of each of the three forms of joint ventures. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) The new International Financial Reporting Standard (IFRS) 9 - Financial Instruments which was issued on 24 July 2014 and which will take effect from 1 January 2018, has generated significant discussions in your country, particularly within the banking sector.

Required:

Explain how IFRS 9 is likely to impact on the provisions for bad and doubtful debts by banks and by extension, the ease of accessing bank loans. (6 marks)

(b) Mwanzo Ltd., Safari Ltd. and Upya Ltd. operate in the clothing industry.

The following information relates to the financial position of the three companies as at 30 September 2017:

		Mwanzo Ltd. Sh."000"	Safari Ltd. Sh."000"	Upya Ltd. Sh."000"
Non-current assets:				
Property, plant and equipment		7,960	4,600	2,680
Patents		500	840	-
Investments in:	Safari Ltd.	5,000		
	Upya Ltd.	1,600		
	Others	300	400	120
		15,360	5,840	2,800
Current assets:				
Inventories		1,140	800	600
Trade receivables		840	760	800
Bank		-	300	240
		1,980	1,860	1,640
Total assets		17,340	7,700	4,440
Equity and liabilities:				
Equity and reserves:				
Ordinary shares of Sh.20 each		4,000	2,000	1,000
Reserves:	Share premium	2,000	1,000	200
	Revenue reserves	9,000	3,800	2,400
		15,000	6,800	3,600

	Sh."000"	Sh."000"	Sh."000"
Non-current liabilities:			
Deferred tax	400	-	160
Current liabilities:			
Trade payables	1,500	900	560
Current tax	280	-	120
Bank overdraft	160	-	-
	1,940	900	680
Total equity and liabilities	17,340	7,700	4,440

Additional information:

1. Mwanzo Ltd. acquired its investments as shown below:

Company	Number of shares acquired	Cost of investment Sh."000"	Retained earnings Sh."000"	Date of acquisition
Safari Ltd.	80,000	5,000	2,400	1 October 2015
Upya Ltd.	20,000	1,600	1,600	1 October 2016

2. At the date of its acquisition, the fair value of Safari Ltd.'s net assets were equal to their book values, with the exception of land that had a fair value of Sh.400,000 in excess of its book value.
3. On 1 September 2017, Mwanzo Ltd. processed an invoice for Sh.100,000 in respect of an agreed allocation of management fee to Safari Ltd. As at 30 September 2017, Safari Ltd. had not accounted for this transaction. Prior to this, the current accounts between the two companies had been agreed at Safari Ltd. owing Sh.140,000 to Mwanzo Ltd. (included in trade receivables and trade payables respectively).
4. During the year ended 30 September 2017, Upya Ltd. sold goods to Mwanzo Ltd. at a selling price of Sh.280,000, which gave Upya Ltd. a profit of 40% on cost. Mwanzo Ltd. had half of these goods in inventory as at 30 September 2017.
5. The fair value of the non-controlling interest (NCI) in Safari Ltd. was Sh.1,500,000.

Required:

Group statement of financial position as at 30 September 2017. (14 marks)

(Total: 20 marks)

QUESTION THREE

Tenda, Mema and Nenda have been in partnership for many years as TMN Enterprises, sharing profits and losses in the ratio of 3:2:1 respectively. Due to the hard economic times, the partners made a resolution to dissolve the partnership.

The partnership's statement of financial position as at 31 August 2017, just prior to the dissolution was as follows:

TMN Enterprises
Statement of financial position as at 31 August 2017

	Sh."000"	Sh."000"
Non-current assets:		
Premises	10,500	
Motor vehicles	4,580	
Furniture and fittings	1,880	
Equipment	2,340	19,300
Current assets:		
Inventories	3,000	
Trade receivables	4,000	
Cash and bank	200	7,200
		26,500
Capital account : Tenda	12,000	
: Mema	8,000	
: Nenda	4,000	24,000
Current account : Tenda	(2,000)	
: Mema	(3,000)	
: Nenda	(6,000)	(11,000)
Non-current liabilities:		
Loan account - Mema	2,000	
Loan from microfinance bank	4,000	6,000
Current liabilities:		
Trade payables and accruals		7,500
		26,500

The terms of dissolution were as follows.

1. The partners to take over the following assets:
   Equipment to be taken over by Tenda at an agreed valuation of Sh.2,000,000.
   Furniture to be taken over by Mema at a valuation of Sh.920,000.
2. The remaining assets were realised on installment basis as follows:

1st installment	Sh.12,000,000
2nd installment	Sh.3,600,000
3rd installment	Sh.2,610,000

3. Nenda was adjudicated bankrupt before the dissolution and liquidation of the partnership was completed.
4. Liquidation expenses amounted to Sh.450,000.
5. Trade payables were settled net of a discount of Sh.700,000.

Required:

(a) A statement of cash distribution. (10 marks)

(b) Realisation account. (5 marks)

(c) Partners capital accounts. (5 marks)

(Total: 20 marks)

QUESTION FOUR

The following trial balance was extracted from the books of Savanna Ltd as at 30 September 2017:

		Sh."000"	Sh."000"
Land		20,100	
Buildings		42,600	
Plant and machinery		216,600	
Accumulated depreciation:	Buildings		6,390
	Plant and machinery		127,710
Revenue			180,030
Cost of sales		65,670	
Inventory (30 September 2017)		6,450	
Distribution costs		6,690	
Administrative expenses		11,340	
Income tax		8,580	
Investment property at fair value (1 October 2016)		20,340	
Finance cost		7,020	
8% redeemable preference shares			15,000
10% debentures			30,000
Intangible assets		34,200	
Trade receivables and trade payables		8,700	5,340
Ordinary shares (each share Sh.20 par value)			90,000
Share premium			6,000
Retained profit (1 October 2016)			7,620
Deferred tax			8,490
Bank and cash balances		1,350	
Investment at fair value		6,940	
		476,580	476,580

Additional information:

1. The fair value of the investment property on 30 September 2017 was Sh.20,790,000.
2. Information relating to intangible assets was as follows:
   - The intangible assets include:

	Cost Sh."000"	Accumulated amortisation Sh."000"
Development cost on software (it is to be amortised over 5 years)	25,800	15,480
Patent	15,600	
Research costs	8,280	

   - The patent was acquired on 1 November 2014. It was determined that the patent had an indefinite useful life when it was acquired. However, on 1 October 2016, due to a new competitor gaining ground on the company's technology, the patent's estimated fair value was established to be Sh.13,500,000 with an estimated useful life of 3 years.
   - The research costs were incurred during the year in developing new software which was not successful.

3. The following details are relevant to the property, plant and equipment:
   - Buildings are depreciated at 2½% per annum on straight line basis.
   - Plant and machinery are depreciated on a straight line basis over 10 years.
   - Depreciation for the current year has been provided.
   - On 30 September 2017, the land and buildings were revalued to Sh.25,500,000 and Sh.45,600,000 respectively. The new values are to be included in the accounts for the financial year ended 30 September 2017.
4. Savanna Ltd. is also a sales agent for Majani Ltd. and is entitled to a sales commission of 10% on the sales made on behalf of Majani Ltd. The net proceeds obtained from the sales (after deducting the commission) are remitted to Majani Ltd. During the financial year ended 30 September 2017, Savanna Ltd. sold goods worth Sh.20,700,000 on behalf of Majani Ltd. This amount was included in the sales revenue disclosed in the above trial balance.
   Savanna Ltd. had not remitted the net sales proceeds to Majani Ltd.
5. Inventory as at 30 September 2017 included partially damaged and slow moving goods. The cost of these goods was Sh.450,000 and they were eventually sold in October 2017 for Sh.128,400.
6. Finance costs comprised:

	Sh."000"
Interest on debentures	3,000
Interim dividends paid on ordinary shares	4,440
Dividends paid on redeemable preference shares	1,200
Investment income from tax exempt companies	(1,620)
	7,020

7. The corporation tax rate is 30%.
8. The balance on the income tax in the trial balance represents the amount paid for the year. The tax expense for the year is estimated to be Sh.7,770,000 inclusive of an increase in deferred tax liability of Sh.1,020,000.

Required:
The following statements in a format suitable for publication:

(a) Comprehensive income statement for the year ended 30 September 2017. (8 marks)

(b) Statement of changes in equity for the year ended 30 September 2017. (4 marks)

(c) Statement of financial position as at 30 September 2017. (8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Explain two key features of a sale and leaseback transaction, citing two advantages of such transactions. (6 marks)

(b) Rejareja Ltd. is a mid-size firm selling electronic keyboards both on cash and hire purchase terms. The following information has been extracted from the firm's books of account as at 30 September 2017:

	Sh."000"	Sh."000"
Share capital		37,500
General operating expenses	65,000	
Cash balance	3,104	
Cash recovered from hire purchase customers		157,734
Cash sales		36,000
Hire purchase trade receivables (1 October 2016)	1,134	
Property, plant and equipment	50,000	
Accumulated depreciation (1 October 2016)		22,500
Retained earnings (1 October 2016)		3,500
Provision for unrealised profit (1 October 2016)		504
Purchases	171,000	
Trade payables		40,000
Inventory (1 October 2016)	7,500	
	297,738	297,738

Additional information:
1. The company's policy is to take credit for gross profit including interest for hire purchase sales in proportion to the cash collected. It does this by raising a provision against the profit included in the hire purchase trade receivables not yet due.
2. The cash selling price is fixed at 50% and the hire purchase selling price at 80% respectively against the cost of goods purchased.

3. The hire purchase contract requires an initial deposit of 20% of the hire purchase selling price, the balance to be paid in four installments at quarterly intervals. The first installment is due three months after the agreement is signed.
4. Hire purchase sales for the year amounted to Sh.270,000,000 (including interest).
5. Depreciation is charged on property, plant and equipment at the rate of 15% per annum on cost. One third of the depreciation relates to cash sales.
6. Operating expenses are to be apportioned on the basis of cash and hire purchase sales.

Required:
Prepare for Rejareja Ltd.:

(i) Income statement for the year ended 30 September 2017 showing separate columns for cash, hire purchase and combined sales. (8 marks)

(ii) Statement of financial position as at 30 September 2017. (6 marks)

(Total: 20 marks)

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