KASNEB

CPA PART II SECTION 3

FINANCIAL REPORTING

THURSDAY: 24 November 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) (i) "The determination of whether the going concern assumption is appropriate is primarily relevant for individual entities rather than for a government as a whole". [Extract from International Public Sector Accounting Standard (IPSAS) 1 – Presentation of Financial Statements].

Required:
In the context of the above statement, outline four factors to be considered in determining whether a public sector entity is a going concern. (4 marks)

(ii) With reference to IPSAS 11 – Construction Contracts, summarise four disclosure requirements for public sector entities with regard to construction contracts. (4 marks)

(b) Digital Limited is a dealer in locally manufactured desktop computers. The following trial balance has been prepared for the company as at 31 August 2016:

	Sh."000"	Sh."000"
Ordinary share capital (Sh.10 par value)		5,000
Share premium		2,500
Retained profits as at 1 July 2015		500
Sales		27,200
Opening inventory	1,440	
Purchases	20,160	
Account receivables	5,030	
Account payables		576
Distribution costs	800	
Administrative expenses	1,000	
Dividends paid	1,400	
Furniture and fittings	3,200	
Motor vehicles	1,800	
Cash at bank	810	
Cash at hand	136	
	35,776	35,776

Additional information:

1. The company buys one computer at Sh.72,000 and sells it on normal cash or credit terms at Sh.100,000.
2. Beginning June 2016, the company started selling computers on hire purchase terms that required a deposit of Sh.34,000 and 15 monthly instalments of Sh.6,000 each with the first instalment being received in the month of sale. The following units were sold on hire purchase:

Month	Units
June 2016	12
July 2016	20
August 2016	30

Two of the units sold in June 2016 were repossessed in early August 2016 after the customer failed to pay the instalment for July 2016. The two units were valued at Sh.98,000 in total and were still unsold by the year end. No adjustments have been made for the repossessions.

3. Depreciation is charged on reducing balance as follows:

Asset	Rate per annum
Furniture	10%
Motor vehicles	20%

4. The sales price presented in the trial balance represents all units sold at cash price. Any hire purchase interest is to be accrued using the sum of digits method.
5. Assume a tax liability of Sh.1,500,000 for the year.

Required:

(i) Income statement for the year ended 31 August 2016. (7 marks)

(ii) Statement of financial position as at 31 August 2016. (5 marks)

(Total: 20 marks)

QUESTION TWO

The following trial balance was extracted from the books of Peak Ltd. as at 31 October 2016:

	Sh."million"	Sh."million"
Land (cost)	400	
Buildings (cost)	1,200	
Plant (cost)	936	
Purchases	469.2	
Distribution expenses	60	
Administrative expenses	33	
Loan interest paid	12	
Leased plant rental	132	
Inventory (1 November 2015)	226.8	
Account receivables	327.2	
Long-term investment	540	
Revenue		1,670.4
Ordinary share capital (Sh.20 par value)		900
Income from investment		27
Retained earnings		717
8% debentures		300
Dividend paid	90	
Account payables		202.4
Cash in hand	2	
Deferred tax		75
Bank overdraft		20.4
Accumulated depreciation: Buildings		360
Plant		156
	4,428.2	4,428.2

Additional information:

1. The 8% debentures were issued on 1 January 2016. Interest is payable six months in arrears.
2. Inventory was valued at Sh.259.2 million as at 31 October 2016.
3. On 1 November 2015, Peak Ltd. entered into a five year lease agreement for an item of plant. This item had an estimated useful life of five years. The annual rental which was payable in advance with effect from 1 November 2015 was Sh.132 million. The fair value of the plant is Sh.552 million and the implicit interest rate is 10% per annum.
4. Plant is depreciated at a rate of 15% per annum using the reducing balance method. Depreciation expense is to be included under cost of sales in the income statement.
5. Land and buildings were revalued on 1 November 2015 at Sh.600 million and Sh.1,050 million respectively. After revaluation, the buildings were estimated to have a useful life of 35 years with nil book value at the end of their economic lives.
6. The corporate tax for the year ended 31 October 2016 was estimated at Sh.169.8 million. The deferred tax provision as at 31 October 2016 was increased to Sh.84.6 million.

Required:

(a) Income statement for Peak Ltd. in a form suitable for publication for the year ended 31 October 2016. (8 marks)

(b) Statement of changes in equity for the period ended 31 October 2016. (4 marks)

(c) Statement of financial position as at 31 October 2016. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) With reference to International Financial Reporting Standard (IFRS) 9 - Financial Instruments:

(i) Describe the provisions governing the initial measurement and subsequent measurement of financial instruments. (4 marks)

(ii) Explain the requirements for derecognition of financial instruments. (4 marks)

(b) Magari Insurance Company Limited specialises in motor vehicle insurance business. The following trial balance was extracted from the books of the company as at 31 October 2016:

			Sh. "000"	Sh. "000"
Ordinary share capital (Sh.100 par value)				200,000
Retained earnings				65,000
Investment income				89,564
Receivables arising out of direct insurance business			8,940	
Payables arising from reinsurance arrangements				6,000
Bank balances				6,000
Investment			79,846	
Property, plant and equipment (net book value)			495,600	
Premium acquisition costs			12,000	
Other operating expenses			101,424	
Depreciation expenses for the year			40,000	
Legal fees on claim settlements			81,690	
Reinsurance share of claims outstanding as at 1 November 2015			16,000	
Gross claims outstanding as at 1 November 2015				240,000
Reinsurance share of sale of salvaged motor vehicles			4,000	
Sale of salvaged motor vehicles				26,000
Gross claims paid			381,784	
Reinsurance share of claims paid				200,000
Unearned premium reserves as at 1 November 2015				40,000
Gross premiums:	From brokers			139,124
	From direct clients			400,000
Reinsurance premiums ceded to:	Reinsurance companies		92,000	
	Reinsurance brokers		88,000	
Commissions payable			30,404	
Reinsurance commissions receivable from:		Reinsurance companies		4,000
		Reinsurance brokers		16,000
			1,431,688	1,431,688

Additional information:

1. The following valuations were made as at 31 October 2016:

	Sh."000"
• Claims outstanding	90,000
• Claims incurred but not reported	158,000

2. Income tax on current year's profit is estimated at Sh.28,000,000.

Required:

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

(ii) Statement of financial position as at 31 October 2016. (4 marks)

(Total: 20 marks)

QUESTION FOUR

The following information was extracted from the financial statements of A Ltd., B Ltd and C Ltd. for the year ended 30 September 2016:

Statement of financial position as at 30 September 2016:

	A Ltd. Sh. "million"	B Ltd. Sh. "million"	C Ltd. Sh. "million"
Non-current assets:			
Property, plant and equipment	950	750	450
Investments	700	-	-
Intangible assets	200	150	100
Current assets:			
Inventories	250	200	120
Trade receivables	220	170	80
Financial assets at fair value	180	130	120
Cash and bank balances	100	50	80
Total assets	2,600	1,450	950
Equity and liabilities:			
Equity and reserves			
Ordinary share capital (Sh.10 par value)	500	200	100
Share premium	200	100	50
Retained earnings	400	350	250
Shareholders funds	1100	650	400
Non-current liabilities:			
10% debentures	600	200	200
Deferred tax	250	100	50
Current liabilities:			
Trade payables	300	250	150
Current tax	250	150	100
Proposed dividends	100	100	50
Total equity and liabilities	2,600	1,450	950

Additional information:

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

Company	Number of shares acquired	Cost of investment Sh. "million"	Retained earnings Sh. "million"	Date of acquisition
B Ltd.	16 million	480	150	1 October 2014
C Ltd.	3 million	120	100	1 October 2015

A Ltd. also invested in half of the 10% debentures of B Ltd. The fair value of the non-controlling interest in B Ltd. amounted to Sh.120 million.

2. Immediately prior to the date of its acquisition, B Ltd. revalued its non-current assets in readiness for the acquisition as shown below:

Item	Carrying amount Sh. "million"	Fair value Sh. "million"	Remaining life (years)
Equipment	250	290	10
Patents	150	160	5

Equipment and patents are depreciated or amortised on a straight-line basis over their remaining useful lives respectively.

3. During the year, A Ltd. sold a non-current asset to B Ltd. for Sh.180 million. A Ltd. marked up the equipment at 20% on cost. B Ltd. included the equipment in its non-current assets and charged depreciation at the rate of 20% per annum on cost.
4. B Ltd. sold inventories to A Ltd. during the year for Sh.150 million. B Ltd. marked up these goods at 50% on cost. Half of these goods were still held by A Ltd. as at the year end.
5. A Ltd. owed B Ltd. Sh.100 million as at the year end with regard to the transaction in note 4 above. The books of A Ltd. however showed that it owed B Ltd. only Sh.80 million. A Ltd. had sent a cheque to B Ltd. on 25 September 2016 which was not received by B Ltd. until 5 October 2016.
6. The group uses the full goodwill method. However, it does not amortise goodwill, instead goodwill is assessed for impairment annually. Impairment test for the year ended 30 September 2016 revealed that none of the goodwill had suffered any impairment since acquisition.

Required:
Group statement of financial position as at 30 September 2016. **(20 marks)**

QUESTION FIVE
Ali, Baba and Chake have been partners sharing profits and losses in the ratio of 2:2:1 respectively. Accounts have been prepared on an annual basis to 31 December of each year. Ali, the only active partner died on 31 May 2016 and the remaining partners decided to dissolve the business from that date. The assets are to be realised, outstanding debts paid and any remaining cash is to be shared by the partners (including the executors of Ali's estate) in an equitable manner, distribution of cash being made as soon as possible.

The statement of financial position as at 31 May 2016 revealed the following:

Ali, Baba and Chake
Statement of financial position as at 31 May 2016:

	"Sh.000"	"Sh.000"	"Sh.000"
Non-current assets:			
Freehold land and buildings			75,000
Plant and machinery			38,600
Fixtures and fittings			8,500
Motor vehicles			4,000
Intangible assets (goodwill)			50,000
			176,100
Current assets:			
Inventory		32,000	
Trade receivables	32,500		
Less: Allowance for doubtful debts	(3,000)	29,500	
Cash		80	61,580
			237,680
Capital and liabilities:			
Capital accounts:			
Ali		50,000	
Baba		30,000	
Chake		20,000	100,000
Current accounts:			
Ali		20,000	
Baba		15,000	35,000
Long-term liabilities:			
Loan - Ali			10,000
Current liabilities:			
Trade payables		28,500	
Bank overdraft		64,180	92,680
			237,680

Additional information:
1. Provision was to be made for dissolution expenses of Sh.1,200,000.
2. Premiums have been paid on life assurance policies for each partner to provide the firm with cash on death. The premiums have been charged to insurance expenses and the cash payable on death of any partner is Sh.20,000,000.

3. The assets were duly sold or settled and the monies received as follows:

		"Sh.000"
20 June 2016:	Life policy on Ali's life	20,000
	Life policy on the lives of Baba and Chake surrendered	10,000
21 July 2016:	Freehold land and buildings	100,000
	Trade receivables (part)	15,000
	Inventory (part)	10,000
18 August 2016:	Plant and machinery	25,500
	Fixtures and fittings	6,000
	Motor vehicles	2,500
25 October 2016:	Inventory (remainder)	18,000
	Trades receivables (remainder)	21,000

4. Dissolution expenses amounted to Sh.1,000,000 and these were paid on 31 October 2016.
5. As soon as sufficient money was available to pay all outstanding creditors, this was done, discounts being received amounting to Sh.500,000.

Required:

(a) Statement showing how the proceeds of the dissolution would be shared among the partners using maximum possible loss method. (12 marks)

(b) Realisation account. (5 marks)

(c) Capital accounts. (3 marks)

(Total: 20 marks)

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