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CPA PART II SECTION 3

FINANCIAL REPORTING

WEDNESDAY: 27 November 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

- (a) International Accounting Standard (IAS) 10 defines events after the reporting date as those events which could be favourable or unfavourable, that occur between the end of the reporting period and the date that the financial statements are authorised for issue.

Required:

With reference to IAS 10:

- (i) Distinguish between “adjusting” and “non-adjusting” events. (2 marks)
- (ii) Describe the accounting treatment of events after the reporting period. (4 marks)
- (b) Chanda, Pete and Tenda have been partners in a business for many years, sharing profits and losses in the ratio of 2:2:1 respectively.

On 30 June 2019, the partners agreed to convert their business into that of a limited liability company to be named Chapete Limited.

The trial balance extracted from the records of the partnership as at 30 June 2019 was as follows:

	Sh.“000”	Sh.“000”
Property at cost (Building: Sh.50 million)	60,000	
Plant and equipment at cost	25,000	
Motor vehicles at cost	12,000	
Furniture and fixtures at cost	4,000	
Provision for depreciation (1 July 2018):		
Building		5,000
Plant and equipment		13,000
Motor vehicles		4,800
Furniture and fixtures		1,600
Net profit for the year to 30 June 2019		28,800
Trade receivables and trade payables	18,200	14,700
Inventory (30 June 2019)	25,300	
Cash at bank balances	8,120	
Fixed capital accounts:		
Chanda		30,000
Pete		20,000
Tenda		10,000
Bank loan		18,000
Current accounts:		
Chanda		4,280
Pete		3,560
Tenda		2,340
Drawings:		
Chanda	1,580	
Pete	1,170	
Tenda	710	
	<u>156,080</u>	<u>156,080</u>

Additional information:

1. The property, plant and equipment in the partnership were being depreciated as follows:

Asset	Rate per annum	Basis
Building	2%	Straight line
Plant and equipment	12½%	Reducing balance
Motor vehicles	20%	Straight line
Furniture and fixtures	10%	Straight line

Depreciation for the year ended 30 June 2019 had not been provided for.

2. The partners were entitled to an interest on their fixed capital balances at the rate of 10% per annum. No salaries were paid to the partners.

3. The tangible non-current assets were to be transferred to the new company at their fair values as follows:

	Sh. "000"
Property	57,000
Plant and equipment	16,000
Motor vehicles	9,500
Furniture and fixtures	3,500

4. The current assets and the liabilities were taken over by the new company at their book values.

5. The purchase consideration amounted to Sh.110 million and was settled by the new company through the issue of ordinary shares of Sh.10 each to the partners in satisfaction of the amounts due to them upon conversion.

Required:

- (i) Realisation account as at 30 June 2019. (6 marks)
- (ii) Partners' capital accounts as at 30 June 2019. (4 marks)
- (iii) Opening statement of financial position as at 1 July 2019 for Chapete Limited. (4 marks)

(Total: 20 marks)

QUESTION TWO

The following trial balance has been extracted from the accounting records of Skytex Limited as at 30 September 2019:

	Sh. "000"	Sh. "000"
6% convertible loan notes		25,000
Ordinary shares (Sh.10 each)		61,000
Retained earnings (1 October 2018)		177,000
Revenue		216,000
Cost of sales	108,500	
Distribution costs	23,600	
Administrative expenses	44,000	
Inventory (30 September 2019)	18,750	
Trade and other receivables	27,300	
Trade and other payables		23,800
Finance costs	6,200	
Investment income		600
Current tax		650
Deferred tax		13,900
Property at cost (Land: Sh.60 million)	170,000	
Accumulated depreciation (1 October 2018)		22,000
Plant and equipment at cost	56,000	
Accumulated depreciation (1 October 2018)		18,000
Bank balance	7,600	
Investment property	120,000	
Suspense account		24,000
	<u>581,950</u>	<u>581,950</u>

Additional information:

1. Skytex Limited entered into a contract with a customer where performance obligation is satisfied over time. The total contract price is Sh.45 million, with total expected contract costs of Sh.25 million.

Progress towards completion was measured at 50% on 30 September 2018 and at 80% on 30 September 2019. The correct entries were made in the year ended 30 September 2018, but no entries have been made for the year ended 30 September 2019.

2. On 1 April 2019, Skytex Limited was notified that an ex-employee had initiated court proceedings against them for unfair termination. Legal advice was that there was an 80% chance that Skytex Limited would lose the case and would be required to pay an estimated amount of Sh.5.06 million in damages on 1 April 2020.

Based on this advice, Skytex Limited recorded a provision of Sh.4 million on 1 April 2019 and has made no further adjustments.

The provision was recorded in administrative expenses and in trade and other payables.

Skytex Limited's cost of capital is 10% per annum and the discount factor at 10% for one year is 0.9091.

3. The company's policy on depreciation is to charge depreciation on building on straight line basis to a nil residual value at the rate of 2% per annum.

The plant and equipment should be depreciated on reducing balance basis at the rate of 12.5% per annum. All depreciation should be charged to cost of sales.

4. The company issued Sh.25 million 6% convertible loan notes on 1 October 2018. Interest is payable annually in arrears. The loan notes can be converted into one share for every Sh.2 of the loan note on 30 September 2020. Similar loan notes, without conversion rights, incur interest at the rate of 8%.

Skytex Limited recorded the full amount in liabilities and has recorded the annual interest payment made on 30 September 2019 of Sh.1.5 million in finance costs.

Relevant discount factors are as follows:

Present value of Sh.1 in:	6%	8%
1 year	0.943	0.926
2 years	0.890	0.857

5. The balance of current tax in the trial balance relates to an under/overprovision from the prior period. The tax estimate for the year ended 30 September 2019 is Sh.10.5 million. In addition, there has been a decrease in taxable temporary differences of Sh.10 million during the year. Skytex Limited pays tax at the rate of 30% and movements in deferred tax are to be taken to the statement of profit or loss.
6. On 1 February 2019, Skytex Limited issued 1.5 million ordinary shares at their full market price of Sh.16 per share. The proceeds were credited to a suspense account.
7. The investment property in the trial balance is stated at fair value as at 30 September 2018. The fair value as at 30 September 2019 amounted to Sh.121.5 million.

Required:

Prepare the following financial statements in a suitable format for publication:

- (a) A statement of profit or loss for the year ended 30 September 2019. (8 marks)
- (b) A statement of changes in equity for the year ended 30 September 2019. (4 marks)
- (c) A statement of financial position as at 30 September 2019. (8 marks)

Note: All workings should be done to the nearest Sh. "000".

(Total: 20 marks)

QUESTION THREE

- (a) International Financial Reporting Standard (IFRS) 15 – Revenue from Contracts with Customers, specifies how and when an entity will recognise revenue.

The standard provides a single principle based five step model to be applied to all contracts with customers.

Required:

Describe the five-step model as specified under IFRS 15.

(10 marks)

- (b) The following trial balance was extracted from the books of Maweo Insurance Company Limited as at 30 September 2019:

	Sh. "000"	Sh. "000"
Property, plant and equipment	10,500	
Depreciation of non-current assets	905	
Investment in government bonds and other securities	1,400	
Gross premiums received from agents		3,000
- Marine		
- Fire		2,500
Gross premiums received from brokers		1,500
- Marine		
- Fire		600
Gross premiums received from direct clients		500
- Marine		
- Fire		1,000
Reinsurance premiums accepted		600
- Marine		
Reinsurance premiums ceded	700	
- Marine	300	
- Fire	750	
Sundry receivables	90	
Bank	495	
Directors fees	240	
Audit fee		
Unearned premiums as at 1 October 2018		4,800
- Marine		
- Fire		2,500
Claims outstanding as at 1 October 2018		1,100
- Marine		
- Fire		840
Claims paid	2,770	
- Marine	2,100	
- Fire	280	
Legal cost on claims		
- Marine		130
- Fire		220
Survey expenses on marine claims		
Bad debts		
- Marine		370
- Fire		320
Management expenses		
- Marine		450
- Fire		380
Trade payables		230
Investment income		280
Ordinary shares of Sh.1,000 each		4,000
Retained profits (1 October 2018)		450
Premiums outstanding (1 October 2018)	800	
- Marine	700	
- Fire	<u>23,900</u>	<u>23,900</u>

Additional information:

- Premiums outstanding as at 30 September 2019 amounted to Sh.1,970,000 and Sh.1,200,000 for Marine Insurance and Fire Insurance respectively.
- Claims intimated and outstanding as at 30 September 2019 amounted to Sh.750,000 for Marine Insurance and Sh.480,000 for Fire Insurance.
- Unearned premium is maintained at 100% and 50% of the premiums received for marine insurance and fire insurance respectively.
- The tax rate applicable is 30%.

Required:

- Revenue accounts for both marine and fire insurance for the year ended 30 September 2019. (6 marks)
- Statement of financial position as at 30 September 2019. (4 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) With reference to International Public Sector Accounting Standard (IPSAS) 5: “Borrowing Costs”, explain the accounting treatment of borrowing costs in the financial statements of a public sector entity and indicate how this treatment differs from the requirements of International Accounting Standard (IAS) 23: “Borrowing Costs”. (4 marks)
- (b) On 1 July 2018, Beyond Ltd. held a number of insignificant investments in equity instruments that do not have a quoted price and are therefore carried at cost. During the year ended 30 June 2019, Beyond Ltd. acquired a subsidiary company, Horizon Ltd. and an associate company, Sky Ltd.

The draft summarised statements of financial position of Beyond Ltd. and its subsidiary company as at 30 June 2019 are shown below:

	Beyond Ltd. Sh. “000”	Horizon Ltd. Sh. “000”
Assets:		
Non-current assets:		
Property, plant and equipment	1,162,800	321,390
Investments	<u>774,500</u>	<u>-</u>
	<u>1,937,300</u>	<u>321,390</u>
Current assets:		
Inventories	523,600	398,500
Trade and other receivables	401,860	203,650
Cash and cash equivalents	<u>52,600</u>	<u>10,000</u>
	<u>978,060</u>	<u>603,250</u>
Total assets	<u>2,915,360</u>	<u>924,640</u>
Equity and liabilities:		
Equity:		
Ordinary share capital (Sh.10 each)	600,000	200,000
Share premium	100,000	50,000
Retained earnings	<u>1,776,260</u>	<u>502,540</u>
	<u>2,476,260</u>	<u>752,540</u>
Current liabilities:		
Trade and other payables	385,200	148,500
Income tax	<u>53,900</u>	<u>23,600</u>
	<u>439,100</u>	<u>172,100</u>
Total equity and liabilities	<u>2,915,360</u>	<u>924,640</u>

Additional information:

- Beyond Ltd. acquired 80% of the ordinary shares of Horizon Ltd. on 1 January 2019. The purchase consideration was made up of cash of Sh.650 million paid on 1 January 2019 and a further cash payment of Sh.147 million deferred until 1 January 2020. No accounting entries have been made in respect of the deferred cash payment. An appropriate discount rate is 5% per annum. Beyond Ltd. recognises goodwill on non controlling interest using the fair value method.
- The fair value of the assets, liabilities and contingent liabilities as at 1 January 2019 were equal to their carrying value with the exception of a machine which had a fair value of Sh.60 million in excess of its carrying amount. This machine had a 6 years remaining useful life on 1 January 2019.
- The fair value of the non controlling interest in Horizon Ltd. on 1 January 2019 was estimated at Sh.150 million.
- In June 2019, Horizon Ltd. sold goods to Beyond Ltd. for Sh.16 million. Half of these goods were still held in the stock of Beyond Ltd. on 30 June 2019. Horizon Ltd. marks up all goods by 20%.
- On 30 June 2019, Horizon Ltd.’s trade receivables still included the Sh.16 million due from Beyond Ltd. However, Beyond Ltd.’s trade payables only included Sh.11 million in respect of this transaction as it had made a payment of Sh. 5 million to Horizon Ltd. on 30 June 2019.
- On 1 July 2018, Beyond Ltd. acquired 30% of the ordinary shares in Sky Ltd. for cash payment of Sh.120.5 million which gave Beyond Ltd. significant influence over Sky Ltd. At that date, a property owned by Sky Ltd. had a fair value of Sh.50 million in excess of its carrying amount. This property had a remaining useful life of 20 years on 1 July 2018.
- In the year ended 30 June 2019, Horizon Ltd. made a profit of Sh.56.8 million out of which it paid a dividend of Sh.20 million on 30 April 2019. Beyond Ltd. debited the dividend received to cash and credited it to investments.

Required:

Consolidated statement of financial position as at 30 June 2019.

(16 marks)
(Total: 20 marks)

QUESTION FIVE

- (a) With reference to International Accounting Standard (IAS) 41 – Agriculture, discuss the accounting treatment of a biological asset. (4 marks)

(Note: Do not discuss the disclosure requirements).

- (b) The following financial statements relate to Orlando Bank Ltd. for the year ended 31 October 2019:

Statement of comprehensive income for the year ended 31 October 2019:

	Sh. "000"
Interest income	364,524
Interest expense	<u>(107,571)</u>
Net interest income	<u>256,953</u>
Fees and commission income	132,374
Fees and commission expense	<u>(24,183)</u>
	<u>108,191</u>
Other income	<u>9,727</u>
Operating income	374,871
Impairment charge on loans and advances	<u>(93,492)</u>
Operating expenses	<u>(169,317)</u>
Profit before tax	112,062
Income tax expense	<u>(33,617)</u>
Profit for the year	<u><u>78,445</u></u>

Statement of financial position as at 31 October:

	2019 Sh. "000"	2018 Sh. "000"
Assets:		
Cash and cash equivalents	577,767	752,303
Government securities	2,037,292	1,851,337
Advances to banks	214,875	107,407
Loans and advances to customers	1,190,782	1,145,133
Property and equipment	139,889	123,936
Intangible assets	18,131	12,162
Income tax assets	<u>6,626</u>	<u>5,778</u>
Equity and liabilities	<u>4,185,362</u>	<u>4,004,056</u>
Equity and liabilities:		
Share capital	100,000	100,000
Retained earnings	<u>545,238</u>	<u>466,793</u>
	<u>645,238</u>	<u>566,793</u>
Liabilities:		
Deposits from customers	3,368,406	3,078,071
Other liabilities and provisions	<u>171,718</u>	<u>359,192</u>
	<u>3,540,124</u>	<u>3,437,263</u>
Total equity and liabilities	<u>4,185,362</u>	<u>4,004,056</u>

Additional information:

1. Interest income comprised:
- | | Sh. "000" |
|---------------------------|----------------|
| Cash and short term funds | 37,652 |
| Loans and advances | <u>326,872</u> |
| | <u>364,524</u> |

During the year, interest received amounted to Sh.131,292,000 while interest paid amounted to Sh.94,578,000.

2. Interest expense comprised:
- | | Sh. "000" |
|-----------------------------|----------------|
| Current and savings account | 57,253 |
| Time and other deposits | 38,828 |
| Borrowings | <u>11,490</u> |
| | <u>107,571</u> |

3. Other income comprised:
- | | Sh. "000" |
|--|--------------|
| Dividends | 9,685 |
| Profit on sale of property and equipment | <u>42</u> |
| | <u>9,727</u> |

Dividends paid during the year amounted to Sh.4,800,000.

4.	Operating expense comprised:	Sh. "000"	
	Staff salaries	125,160	
	Advertising and marketing expenses	498	
	Training cost	4,241	
	Audit fees	696	
	Directors fees	1,957	
	Depreciation of property and equipment	30,688	
	Amortisation of software	<u>6,077</u>	
		<u>169,317</u>	
5.	Property, plant and equipment movement schedule:	2019	2018
	Cost:	Sh. "000"	Sh. "000"
	Balance brought forward	228,657	165,128
	Additions	46,641	63,672
	Disposal	<u>(120)</u>	<u>(143)</u>
	Balance carried down	<u>275,178</u>	<u>228,657</u>
	Depreciation:		
	Balance brought forward	104,721	83,729
	Charge for the year	30,688	21,135
	Released on disposal	<u>(120)</u>	<u>(143)</u>
	Balance carried down	<u>135,289</u>	<u>104,721</u>
	Net book value	<u>139,889</u>	<u>123,936</u>
6.	Intangible assets:	2019	2018
	Cost	Sh. "000"	Sh. "000"
	Balance bought forward	24,241	13,077
	Additions	<u>12,046</u>	<u>11,164</u>
	Balance carried down	<u>36,287</u>	<u>24,241</u>
	Amortisation:		
	Balance brought forward	12,079	9,123
	Charge for the year	<u>6,077</u>	<u>2,956</u>
	Balance carried down	<u>18,156</u>	<u>12,079</u>
	Net book value	<u>18,131</u>	<u>12,162</u>

Required:

Using the indirect method, prepare a statement of cash flows for the year ended 31 October 2019 in accordance with International Accounting Standard (IAS 7): Cash Flow Statement.

(16 marks)

(Total: 20 marks)

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