KASNEB

CPA PART II SECTION 3

FINANCIAL REPORTING

THURSDAY: 25 May 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) With reference to International Public Sector Accounting Standard (IPSAS) 14 – Events After the Balance Sheet Date:

(i) Describe the two categories of events after the balance sheet date. (4 marks)

(ii) Explain two disclosure requirements for each category of events identified in (a) (i) above. (4 marks)

(b) In the context of International Accounting Standard (IAS) 40 – Investment Property:

(i) Define an "investment property", citing two examples. (4 marks)

(ii) Identify two types of property that are specifically not considered as investment property. (2 marks)

(iii) Discuss the fair value model as applied in the valuation of investment property. (6 marks)

(Total: 20 marks)

QUESTION TWO

Dida and Vuma were partners in a wholesale business. The following balances were extracted from their books of account as at 30 April 2017:

	Debit Sh."000"	Credit Sh."000"
Accruals		9,000
Capital account: Dida		20,000
Vuma		30,000
Equipment	20,000	
Motor vehicles at cost	55,000	
Accumulated depreciation: Equipment		8,000
Motor vehicles		25,000
Cash and bank balances	21,000	
Drawings: Dida	15,000	
Vuma	10,000	
Net profit for the year to 30 April 2017		149,000
Prepayments	3,000	
Salary paid to Vuma	20,000	
Inventory at cost (30 April 2017)	70,000	
Trade payables		118,000
Trade receivables	100,000	
Premises	45,000	
	359,000	359,000

Additional information:

1. The partnership agreement includes the following arrangements between the partners:

   - Profits and losses are to be shared in the ratio of 3:1 for Dida and Vuma respectively.
   - Interest of 15% per annum is to be paid on the partners' fixed capital.
   - Interest at a rate of 10% per annum is to be charged on partners' drawings.
   - Vuma is entitled to a salary of Sh.20 million per annum.

2. On 1 May 2017, a company known as Fariji Ltd. was incorporated in order to make an offer for the purchase of the partnership business. The arrangements were as follows:

   - Vuma to take over one of the motor vehicles at an agreed valuation of Sh.5 million.

Other assets and liabilities (except cash) were taken over by the company at the following values:

	Sh. "000"
Premises	50,000
Motor vehicles	18,000
Equipment	10,000
Trade payables	80,000
Accruals	10,000

Inventory net of 10% for obsolete stock
Receivables net of provision for doubtful debts of 5%
Prepayments were valueless

3. Additional costs incurred by the partnership in arranging the sale of the business amounted to Sh.3 million.
4. The company agreed to issue 15 million shares of Sh.10 each at a premium of 24%. The shares were to be divided between Dida and Vuma in the ratio of 3:2 respectively.
5. The partners' drawings were made in the following months:
   Dida : November 2016
   Vuma : February 2017
6. The rule of Garner Vs Murray is to apply.

Required:

(a) Realisation account. (8 marks)
(b) Partners' capital accounts. (5 marks)
(c) Statement of financial position of Fariji Ltd. as at 2 May 2017. (7 marks)

(Total: 20 marks)

QUESTION THREE

The following trial balance relates to Apple Ltd. as at 31 March 2017:

		Sh. "000"	Sh. "000"
Ordinary shares of Sh.10 par value			100,000
Share premium			40,000
Retained earnings (1 April 2016)			22,400
Land and buildings at cost (Land Sh.40 million)		120,000	
Plant and equipment at cost		189,000	
Accumulated depreciation: 1 April 2016:	Buildings		40,000
	Plant and equipment		49,000
Inventories (31 March 2017)		87,400	
Trade receivables		84,400	
Bank balance			13,600
Deferred tax			12,400
Trade payables			70,200
Revenue			1,100,000
Cost of sales		823,000	
Distribution costs		43,000	
Administrative expenses		61,800	
Dividends paid		40,000	
Bank interest		1,400	
Current tax			2,400
		1,450,000	1,450,000

Additional information:

1. On 1 April 2016, the company's directors decided that land and buildings should be revalued at their market values. At that date, an independent expert valued land at Sh.24 million and buildings at Sh.70 million and these valuations were accepted by the directors. The remaining useful life of buildings on that date was 14 years. The company does not make a transfer to retained earnings for excess depreciation.
2. Plant and equipment is depreciated at 20% per annum using the reducing balance method and time apportioned as appropriate. Depreciation for the year is yet to be accounted for.
3. Directors' remuneration amounting to Sh.11 million should be provided for and is classified as administrative cost.
4. Income tax provision of Sh.54.4 million is required for the year ended 31 March 2017. As at that date, deferred tax liability amounted to Sh.18.8 million. The movement in deferred tax should be taken to profit or loss. The balance on the current tax in the trial balance represents over/under provision of tax liability for the year ended 31 March 2016.
5. On 1 July 2016, the company made a rights issue of 1 share for every 4 shares at Sh.24 each. Immediately before this issue, the stock market value of the shares was Sh.40 each.

Required:

(a) Statement of comprehensive income for the year ended 31 March 2017. (8 marks)

(b) Statement of changes in equity as at 31 March 2017. (4 marks)

(c) Statement of financial position as at 31 March 2017. (8 marks)

(Total: 20 marks)

QUESTION FOUR

The following financial statements relate to Hema Ltd. and its investment companies Shuka Ltd. and Ajabu Ltd. for the year ended 30 April 2017:

Income statement for the year ended 30 April 2017

	Hema Ltd. Sh. "million"	Shuka Ltd. Sh. "million"	Ajabu Ltd. Sh. "million"
Revenue	1,200	600	300
Cost of sales	(650)	(250)	(100)
Gross profit	550	350	200
Investment income	70	-	1
Distribution cost	(100)	(40)	(30)
Administrative expense	(130)	(90)	(50)
Finance cost	(40)	(20)	(20)
Profit before tax	350	200	101
Income tax expense	(70)	(50)	(31)
Profit for the year	280	150	70
Dividends paid	(50)	(50)	(30)
Retained profit for the year	230	100	40
Retained profit brought forward	480	275	160
Retained profit carried forward	710	375	200

Statement of financial position as at 30 April 2017

	Hema Ltd. Sh. "million"	Shuka Ltd. Sh. "million"	Ajabu Ltd. Sh. "million"
Assets:			
Non-current assets:			
Property, plant and equipment	1,250	800	650
Intangible assets	200	70	80
Investments	850	50	20
	2,300	920	750
Current assets:			
Inventory	200	75	60
Trade and other receivables	300	90	80
Financial assets at fair value	30	20	10
Cash and cash equivalents	150	40	40
	680	225	190
Total assets	2,980	1,145	940
Equity and liabilities:			
Equity:			
Ordinary share capital	1,000	200	200
Share premium	300	50	50
Revaluation reserve	200	50	50
Retained profits	710	375	200
	2,210	675	500
Non-current liabilities:			
10% loan stock	500	200	200
Current liabilities:			
Trade and other payables	250	250	220
Current tax	20	20	20
	270	270	240
Total equity and liabilities	2,980	1,145	940

Additional information:

1. Hema Ltd. acquired the investments in other companies as follows:

Company	Date	Shareholding	Cost of purchase Sh. "million"	Revaluation reserve Sh. "million"	Retained profits Sh. "million"
Shuka Ltd.	1 May 2014	80%	300	20	80
Ajabu Ltd.	1 May 2015	40%	200	25	150

Hema Ltd. also invested in half of the 10% loan stock in Shuka Ltd.

2. The fair value of the non-controlling interest in Shuka Ltd. was Sh.75 million on 1 May 2014.
3. During the year ended 30 April 2017, Hema Ltd. sold goods to Shuka Ltd. and Ajabu Ltd. as follows:

	Selling price Sh. "million"	Mark up %	% of goods held in stock
Shuka Ltd.	100	25	50
Ajabu Ltd.	50	25	Nil

4. On 1 May 2016, Hema Ltd. sold Shuka Ltd. an item of plant for Sh.200 million reporting a 25% profit on cost of the plant. The group charges depreciation at 20% per annum on cost of plant.
5. All the goodwill of the two companies in which Hema Ltd. has invested are estimated to be impaired by 60% to the year ended 30 April 2017. 20% of the impairment relates to the current year.
6. Trade receivables and trade payables included Sh.50 million due from Shuka Ltd. to Hema Ltd. and Sh.10 million due from Ajabu Ltd. to Hema Ltd.
7. All dividends and interest had been paid by the end of the year.

Required:

(a) Consolidated income statement for the year ended 30 April 2017. (10 marks)

(b) Statement of changes in equity for the year ended 30 April 2017. (2 marks)

(c) Consolidated statement of financial position as at 30 April 2017. (8 marks)

(Total: 20 marks)

QUESTION FIVE

(a) Distinguish between "value based" and "cost based" method in determining the stage of completion of a construction contract. (6 marks)

(b) The following trial balance was extracted from the books of Malipo Insurance Company Ltd. which specialises in general insurance as at 31 March 2017:

		Sh. "million"	Sh. "million"
Freehold property		5,040	
Motor vehicle (net book value)		4,200	
Machinery and equipment (net book value)		1,800	
Furniture (net book value)		1,560	
Audit fees paid		288	
Directors fees		594	
Depreciation on non-current assets		1,086	
Management expenses:	Marine	780	
	Fire	696	
Accounts receivable and accounts payable		876	396
Investment income			336
Ordinary share capital			3,600
Share premium			1,200
Retained profit as at 1 April 2016			540
Premiums outstanding as at 1 April 2016:	Marine	1,080	
	Fire	840	
Unearned premiums as at 1 April 2016:	Marine		5,760
	Fire		3,000
Claims outstanding as at 1 April 2016:	Marine		960
	Fire		648
Claims paid:	Marine	2,964	
	Fire	2,160	

		Sh. "million"	Sh. "million"
Legal costs:	Marine	216	
	Fire	156	
Expenses relating to claims (Marine)		384	
Bad debts written off:	Marine	204	
	Fire	144	
Investment in shares		1,680	
Direct premiums received:	Marine		5,400
	Fire		4,200
Re-insurance premiums received:	Marine		1,440
	Fire		960
Re-insurance premiums paid:	Marine	960	
	Fire	600	
Bank balance and cash in hand		132	
		28,440	28,440

Additional information:

1. Unearned premiums reserve for unexpired risk is to be maintained at 100% and 50% of the premiums for marine insurance and fire insurance respectively.
2. Commission on both insurance ceded and re-insurance accepted is at a rate of 5% of the premiums.
3. The directors have proposed a dividend of 5% on the outstanding share capital as at 31 March 2017.
4. The tax rate applicable is 30%.
5. Premiums outstanding as at 31 March 2017 amounted to Sh.1,800 million and Sh.840 million for marine insurance and fire insurance respectively.
6. Claims intimated and outstanding as at 31 March 2017 amounted to Sh.900 million for marine insurance and Sh.576 million for fire insurance.

Required:

(i) Revenue account for both marine insurance and fire insurance for the year ended 31 March 2017. (5 marks)

(ii) Statement of comprehensive income for the year ended 31 March 2017. (3 marks)

(iii) Statement of financial position as at 31 March 2017. (6 marks)

(Total: 20 marks)

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