

Financial Reporting

SUBJECT No. 9

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ACKNOWLEDGMENT

We gratefully acknowledge permission to quote from the past examination papers of the following bodies: **Kenya Accountants and Secretaries National Examination Board (KASNEB); Chartered Institute of Management Accountants (CIMA); Chartered Association of Certified Accountants (ACCA).**

INSTRUCTIONS FOR STUDENTS

This study guide is intended to assist distance-learning students in their independent studies. In addition, it is only for the personal use of the purchaser, see copyright clause. The course has been broken down into eight lessons each of which should be considered as approximately one week of study for a full time student. Solve the reinforcement problems verifying your answer with the suggested solution contained at the back of the distance learning pack. When the lesson is completed, repeat the same procedure for each of the following lessons.

At the end of lessons 2, 4, 6 and 8 there is a comprehensive assignment that you should complete and submit for marking to the distance learning administrator.

SUBMISSION PROCEDURE

1. After you have completed a comprehensive assignment clearly identify each question and number your pages.
2. If you do not understand a portion of the course content or an assignment question indicate this in your answer so that your marker can respond to your problem areas. Be as specific as possible.
3. Arrange the order of your pages by question number and fix them securely to the data sheet provided. Adequate postage must be affixed to the envelope.
4. While waiting for your assignment to be marked and returned to you, continue to work through the next two lessons and the corresponding reinforcement problems and comprehensive assignment.

On the completion of the last comprehensive assignment a two-week period of revision should be carried out of the whole course using the material in the revision section of the study pack. At the completion of this period the final Mock Examination paper should be completed under examination conditions. This should be sent to the distance-learning administrator to arrive in Nairobi at least five weeks before the date of your sitting the KASNEB Examinations. This paper will be marked and posted back to you within two weeks of receipt by the Distance Learning Administrator

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FINANCIAL REPORTING COURSE DESCRIPTION

The study pack is comprehensively prepared for the students of C.P.A Section 3 to adequately attempt the Financial Accounting 3 paper set by the Kenya Accountants and Secretaries National Examination Board (KASNEB). To cover the course material sufficiently, the student needs to not only study the course materials, but also to practice as much as possible using the past paper questions, the comprehensive assignments and reinforcement questions provided.

The Financial Accounting 3 paper covers the following areas:

- i) **Partnership Accounts**
Partnerships were introduced in financial accounting 1. More advanced issues especially in changes of partnerships are covered here and this include admission, retirement, dissolutions, amalgamations and conversion into a company.
- ii) **Preparation of Published Financial Statements**
The student is introduced to the preparation of financial statements for public use. Such financial statements are prepared under the provisions of the Companies Act as well as other relevant regulatory bodies and the requirements of the relevant International Financial Reporting Standards. More emphasis is placed on international Financial Reporting standards.
- iii) **Branch Accounts**
Preparation of branch accounts is another important aspect of Financial Accounting III. This borrows slightly from departmental accounts and involves consideration of the various types of branches a business has including foreign branches.
- iv) **Group Accounts**
This is the core area in Financial Reporting and has been examined in almost all sittings. It involves the preparation of financial statements of companies that are related in a group and lays emphasis on the requirements of International Financial Reporting standards.
- iv) **Bankruptcy and Liquidation**
The section covers what constitutes bankruptcy and receivership, and the legal processes involved for individuals and body corporate. The process of distributing the assets of a body entity that is liquidated is also addressed. The bankruptcy of partners in a partnership is described in this section. It is very important that the student notes the accounting issues raised here, especially the preparation of the statement of affairs and the deficiency account.
- v) **Executorships and Trust Accounts**
Executorship is mainly concerned with the disposal of the assets of the deceased using the provisions of the Succession Act or the will of the deceased, as the case may be. Issues of the validity of wills are addressed here. The order in which the beneficiaries are satisfied and the reasons that may make beneficiaries not receive their dues are important to note. Last but not least, the preparation of the executorship accounts is described and illustrated.

We hope the students will enjoy going through this course and will develop important insights into accounting and have a firm foundation for advanced accounting and its related subjects in other areas of the academic world.

LESSON ONE

PARTNERSHIPS

OBJECTIVES

At the end of this lesson, you should be able to:

- Deal with the more complex aspects of partnership accounting dealing with realignments and dissolutions;
- Deal with accounting for the conversion of a partnership into a limited liability company;
- Know the provisions of the Partnership Act.

Much of what you need to know at the end of this lesson has already been covered in Financial Accounting I in CPA Section I (see Lesson 5 of Strathmore University Distance Learning Centre Study Pack).

CONTENTS

- 1.1 Introduction to Partnerships
- 1.2 Goodwill, revaluations and life policy.
- 1.3 Admission and retirement.
- 1.4 Dissolutions.
- 1.5 Amalgamations.
- 1.6 Conversion into a limited liability company

Attempt reinforcing questions at the end of the lesson and compare them with solutions given in lesson 9.

1.1 INTRODUCTION:

This chapter covers the more complex aspects of dealing with partnerships. At this level partnerships may be examined from every possible angle, therefore this chapter will be considering partnerships to the maximum possible depth.

Much of what you need to know by the end of this lesson has already been covered in Financial Accounting 1 in CPA 1. Thus, only a basic revision of these concepts will be undertaken at the beginning of this chapter.

Definition:

A partnership is defined as “the relationship that subsists between two or more persons carrying on a business in common with a view to making a profit.” (Partnership Act).

Membership:

There may be a minimum of two and a maximum of twenty members in a partnership. In the U.K however, the Partnership Act 1934 CAP 29 provides that the maximum number of partners in a firm that offers personal/professional services may be up to 50 if each partner is professionally qualified, e.g. Accountants, Lawyers, architects doctors, surgeons etc.

Types of Partners:

Partners may be classified into the following categories:

- a) Active or dormant;
- b) Limited or Unlimited;
- c) Adult or Minor;
- d) Real or Quasi.

Legal Formalities for the Formation of a Partnership.

There are no legal formalities if the partners carry on business in their own names. However, if they carry on business in another name, then the business must be registered with the registrar of business names.

The Partnership Deed:

It is the agreement that regulates the partners actions in undertaking the partnership business.

This may or may not have been drawn up. It usually contains, amongst others:

- Name of the firm, names of the partners, their addresses and their occupations;
- The status/type of each partner, e.g. active/dormant, limited/unlimited etc
- The capital to be contributed by each partner
- Their profit sharing ratio
- Salaries to partners, if any
- Interest, if any on capital/drawings.

Provisions of the Partnership Act

In the event of absence of a partnership agreement/deed or in the event of ambiguity therein, the provisions to the partnership Act will apply. The provisions state that, unless the partnership deed indicates otherwise,

- Every partner has a right to take part in the conduct of business;
- All profits/losses are to be shared equally;
- No interest on capital is to be allowed;
- No partner is entitled to a salary;
- No interest on drawings is to be charged;
- 6% per annum is to be allowed on amounts contributed by each partner exceeding the agreed capital amounts;
- normal business decisions can be taken by a majority vote;
- Major business decisions e.g. major business changes must obtain the full consent of all partners.

Dissolution of a partnership:

A partnership is dissolved when:

- It is temporary (maybe set up for a given period which has lapsed);
- One partner notifies the others in writing, of his intention to retire;
- A partner dies, becomes insane or bankrupt;
- The partnership becomes unlawful.

Accounting for Partnerships

The owners' interests in the business are divided into long term and short-term interests. (Long-term interests refer to original capital commitments and changes thereon. Short-term interests refer to shares of annual profit and amounts therein withdrawn). The long-term interests are shown in a capital account whereas short-term interests are shown in a current account.

These accounts are kept in a T-form for examination purposes, a separate column being kept for each partner.

Example of a current account where there are 3 partners A, B and C:

Current Account							
	A	B	C		A	B	C
Bal b/d (Note 1)		X		Bal b/d (Note 1)	X		X
Interest on drawings (Note 2)	X	X	X	Interest on capital (Note 3)	X	X	X
Drawings	X	X	X	Salaries (Note 4)	X	X	X
				Interest on loan	X	-	-
				Share of profit (Note 5)	X	X	X
Bal c/d (Note 6)	X	X	-	Bal c/d (Note 6)	-	-	X
	XX	XX	XX		XX	XX	XX
	-	-	X	Bal b/d	X	X	-

Example of a capital account where there are 3 partners A, B, and C:

	A	B	C		A	B	C
Goodwill written off	X	X	X	Bal b/f	X	X	X
Deficit on revaluation	X	X	X	Additional capital brought in as per agreement	X	X	X
				Goodwill	X	X	X
Bal c/d	X	X	X	Surplus on revaluation	X	X	X
	XX	XX	XX		XX	XX	XX
				Bal b/d	X	X	X

Format for Trading Profit and Loss A/CS:

The trading section remains identical to that of a sole proprietorship, and so does the profit and loss section. However an additional section is now brought in (called the appropriation account) in which profits are divided amongst partners.

The appropriation account is a continuation of the P&L account in a similar situation to which the P&L account is a continuation of the trading account.

Example of a P&L Appropriation A/C where there are 3 partners A, B and C:

	Sh		Sh		Sh
Net profit (as per trading, profit & loss a/c)					X
Add: Interest on drawings:	A	Note 2	}	X	
	B			X	
	C			<u>X</u>	<u>X</u>
					X
Less: Interest on capital:	A	Note 3	}	X	
	B			X	
	C			<u>X</u>	<u>X</u>
					X
Salaries:	A	Note 4	}	X	
	B			X	
	C			<u>X</u>	<u>X</u>
				X	(X)
Balance shared according to agreed profit sharing ratio				<u>X</u>	X
Share of profits	Note 5	}	A	X	
			B	X	
			C	<u>X</u>	<u>X</u>

Note 1: (See current A/C)

The opening balances for the current accounts can be extracted from the trial balance. These balances may be debit balances b/d or credit balances b/d. A credit balance b/d is a favorable balance for the partner, i.e he has not yet withdrawn all his dues from the firm. A debit balance means the partner has overdrawn his "account".

Note 2: (See current A/C and appropriations A/C)

Ideally, the partner should wait until the end of the year when the profit is ascertained and divided up before he can take his share. However, commitments may arise partway through the year thus forcing the partner to withdraw money earlier. The firm will treat this as a "loan" extended to the partner until the end of the year. This will attract interest (known as interest on drawings), which is income to the firm and is added to the net profit.

It is a "loss" to the partner and is therefore debited to his current account.

Note 3: (See current A/C and appropriation A/C)

In a partnership, the partners need not contribute equal capital to go into business. Therefore, in order to prevent dissatisfaction amongst partners (i.e "why should I bring in more capital than you?") Some of the profits of the firm are given to partners in the name of "interest on capital". This is a

percentage of fixed capital and therefore the larger the capital contribution by the partner, the larger his share of profit will be.

Note 4: (See Current A/C and appropriation A/C)

Some of the partners may remain in the business on a full time basis to oversee the day to day running/management of the business, instead of seeking alternative employment elsewhere (thus earning some more income elsewhere). Part of the available profit will be awarded to them in the name of “salaries” to compensate them for loss of income elsewhere.

Note 5: (See Current A/C and appropriations A/C)

If any profit remains after some has been given to partners in the names of “interest on capital” and “salaries”, then this will be divided amongst partners in profit sharing ratio. NB: If this was a loss, then it will appear on the debit side of the current A/C.

Note 6: [See current A/C and statement of financial position format (below)]

The final balance computed in the current A/C represents the owners’ short term interests at the end of the year. Once again, if the balance b/d is a debit figure, then it is favorable to the partner. If the balance b/d is a debit figure, this is unfavorable to the partner (he has drawn more than his profit share) and this entry will appear as negative in the statement of financial position.

FORMAT FOR STATEMENT OF FINANCIAL POSITION

The non current assets, current assets and current liabilities sections remain identical to those of a sole proprietorship. However, the “capital section will change to reflect the capital contribution by each partner..

Example of statement of financial position where there are 3 partners A, B and C.

	(Name)		
	Statement of financial position as at (date)		
	Cost (Shs)	Depreciation (Shs)	NBV (Shs)
Non Current assets			
Land & Buildings	X	X	X
Fixtures & Fittings	X	X	X
Plant & Machinery	X	X	X
Motor Vehicles	X	X	X
	XX	XX	XX
Investments, goodwill etc			X
Current Assets			
Inventory		X	
Receivables	X		
Less provision for bad and doubtful debts	<u>(X)</u>	X	
Prepayments		X	
Bank		X	
Cash		X	
		X	
Current Liabilities			
Payables	X		
Accruals	X	<u>(X)</u>	

Working capital (C.A – C.L)		X	XX
Financed by:			
Capitals: A		X	
B		X	
C		X	
Current A/Cs: A	} See Note 6	X	
B		X	
C		(X)	X
Long term loans		X	XX

Note: If a partner extended a loan to the partnership (over and above the capital) then the interest on such will be an expense in the P&L (before the net profit is computed), and not an appropriation. The amount will be credited to the partner's current a/c as due to him. (See Current A/C format)

Example one

The following list of balances as at 30 September 20X9 has been extracted from the books of Brick and Stone, trading in partnership, sharing the balance of profits and losses in the proportions 3:2 respectively.

	Kshs.
Printing, stationery and postages	3,500
Sales	322,100
Inventory in hand at 1 October 20x8	23,000
Purchases	208,200
Rent and rates	10,300
Heat and light	8,700
Staff salaries	36,100
Telephone charges	2,900
Motor vehicle running costs	5,620
Discounts allowable	950
Discounts receivable	370
Sales returns	2,100
Purchases returns	6,100
Carriage inwards	1,700
Carriage outwards	2,400
Fixtures and fittings: at cost	26,000
Provision for depreciation	11,200
Motor vehicles: at cost	46,000
Provision for depreciation	25,000
Provision for doubtful debts	300
Drawings: Brick	24,000
Stone	11,000
Current Account balances at 1 October 20x8:	
Brick	3,600
Stone	2,400
Capital account balances at 1 October 20x8:	

Brick	33,000
Stone	17,000
Receivables	9,300
Payables	8,400
Balance at bank	7,700

Additional information:

1. Kshs.10,000 is to be transferred from Brick's capital account to a newly opened Brick Loan Account on 1 July 20X9. Interest at 10 per cent per annum on the loan is to be credited to Brick.
2. Stone is to be credited with a salary at the rate of Kshs.12,000 per annum from 1 April 20X9.
3. Inventory in hand at 30 September 20X9 has been valued at cost at Kshs.32,000.
4. Telephone charges accrued due at 30 September 20X9 amounted to Kshs.400 and rent of Kshs.600 prepaid at that date.
5. During the year ended 30 September 20X9 Stone has taken goods costing Kshs.1,000 for his own use.
6. Depreciation is to be provided at the following annual rates on the straight line basis:

Fixtures and fittings	10%
Motor Vehicles	20%

Required:

- (a) Prepare income statement for the year ended 30 September 20X9.
- (b) Prepare statement of financial position as at 30 September 20X9 which should include summaries of the partner's capital and current accounts for the year ended on that date.

Note: In both (a) and (b) vertical forms of presentation should be used.

Solution:

a)

Brick and Stone**Income statement for the year ended 30 September 20X9**

	Kshs.	Kshs.	Kshs.
Sales			322,100.00
Less sales returns			<u>(2,100.00)</u>
			320,000.00
Less cost of sales			
Opening inventory		23,000.00	
Purchases	207,200.00		
Carriage inwards	<u>1,700.00</u>		
	208,900.00		
Less purchases returns	<u>(6,100.00)</u>	<u>202,800.00</u>	
		225,800.00	
Less closing inventory		<u>(32,000.00)</u>	<u>(193,800.00)</u>
Gross Profit			126,200.00
Discounts receivable			<u>370.00</u>
			126,570.00
Less Expenses:			
Printing, stationery and postages		3,500.00	

Rent and rates	9,700.00	
Heat and light	8,700.00	
Staff salaries	36,100.00	
Telephone charges	3,300.00	
Motor vehicle running costs	5,620.00	
Discounts allowable	950.00	
Carriage outwards	2,400.00	
Depreciation: Fixtures and fittings	2,600.00	
Motor vehicles	9,200.00	
Loan – Brick	<u>250.00</u>	(82,320.00)
Net profit		44,250.00
Less Salary – Stone		<u>(6,000.00)</u>
		38,250.00
Balance of profits shared in PSR		
Brick	22,950.00	
Stone	15,300.00	<u>(38,250.00)</u>

b)

Brick and Stone
Statement of financial position as at 30 September 20X9

	Cost	Accumulated Depreciation	NBV
	Kshs.	Kshs.	Kshs.
Non Current assets			
Fixtures and fittings	26,000.00	(13,800.00)	12,200.00
Motor vehicles	<u>46,000.00</u>	<u>(34,200.00)</u>	<u>11,800.00</u>
	<u>72,000.00</u>	<u>(48,000.00)</u>	24,000.00
Current Assets			
Inventory		32,000.00	
Receivables	9,300.00		
Less provision for doubtful debts	<u>(300.00)</u>	9,000.00	
Prepaid expenses		600.00	
Balance at bank		<u>7,700.00</u>	
		49,300.00	
Current liabilities			
Payables	8,400.00		
Accrued expenses	<u>400.00</u>	(8,800.00)	
Net working capital			<u>40,500.00</u>
			<u>64,500.00</u>
Capital accounts			
Brick		23,000.00	
Stone		<u>17,000.00</u>	40,000.00
Current Account			
Brick		2,800.00	
Stone		<u>11,700.00</u>	<u>14,500.00</u>
			54,500.00
Loan Account			<u>10,000.00</u>
			<u>64,500.00</u>

Current Account					
	Brick Kshs.	Stone Kshs.		Brick Kshs.	Stone Kshs.
Drawings	24,000.00	12,000.00	Balance b/f	3,600.00	2,400.00
			Interest/salary	<u>250.00</u>	<u>6,000.00</u>
Bal c/d	<u>2,800.00</u>	<u>11,700.00</u>	Profit share	<u>22,950.00</u>	<u>15,300.00</u>
	<u>26,800.00</u>	<u>23,700.00</u>		<u>26,800.00</u>	<u>23,700.00</u>

Example two

A and B are in partnership as manufacturers of high quality wheelbarrows, A being responsible for the factory and B being responsible for sales. Completed wheelbarrows are transferred from the factory to the warehouse at agreed prices. A and B are credited with interest on capital balances at 5% and an annual salary of sh.100, 000 each. The balance of the profits is shared as follows between the partners.

- i) A gets one third of the manufacturing profit.
- ii) B gets 10% of the gross profit and
- iii) The balance is shared equally.

Interest is charged on drawings at 10% based on the total drawings at the end of the year.

All wheelbarrows are sold at Sh.6, 800.00 each

The following trial balance was extracted on 31 March 2004.

Capital Accounts	Sh.	Sh
A		4,500,000.00
B		5,000,000.00
Current Accounts		
A		320,000.000
B		76,000.000.00
Drawings		
A	1,060,000.00	
B	974,000.00	
Freehold factory (including land Sh. 3,000,000.00)	7,088,000.00	
Factory plant at cost	3,264,000.00	
Delivery van cost	820,000.00	
Provision for depreciation		
Freehold factory		3,070,400.00
Factory Plant		1,101,600.00
Delivery van		384,000.00
Inventory on April 2003		
Raw materials	420,000.00	
Work in progress	402,000.00	
Wheelbarrows (1,220 at Sh.4, 400)	5,368,000.00	
Sales		12,376,000.00

Returns inwards	136,000.00	
Purchase of raw materials	2,916,000.00	
PAYE		88,000.00
Factory wages	1,654,000.00	
Office salaries	230,000.00	
Expenses		
factory	1,268,000.00	
Office	1,009,000.00	
Provision for unrealized profit		488,000.00
provision for doubtful debts		192,000.00
Accounts receivables and payables	2,176,000.00	1,302,000.00
Bank	113,000.00	
	<u>28,898,000.00</u>	<u>28,898,000.00</u>

Additional information

- 1540 wheelbarrows at Sh.4, 800 each were transferred to the warehouse during the year. Wheelbarrow in stock being balance of the current year's production, were valued at agreed price of Sh.4, 800 each.
- The stock of raw materials was Sh.340, 000 and work in progress is valued at Sh.536, 000.00.
- Accrued expenses on 31st March 2004 amounted to 624,000 (including office Sh.328, 000.00) and prepaid rates Sh.32, 000(including office Sh.12, 000.00)
- Provision for depreciation is to be made as follows

Factory buildings	2% p.a.
Factory plant	10% p.a.
Motor vehicles	25% p.a.

- The general provision for doubtful debts is to maintain at 10% of the trade debtors.

Required

A manufacturing, trading and profit and loss Accounts for the year ended 31 March 2004 and statement of financial position as at the date.

A and B

Manufacturing, Trading and Profit and Loss Account For the year ended 31 March 2004

	£	£
Opening inventory raw materials		420,000
Purchases of raw materials		2,916,000
		3,336,000
Less: closing stock raw materials		(340,000)
Raw materials consumed		2,996,000
Direct expenditure: factory wages		<u>1,654,000</u>
PRIME COST		<u>4,650,000</u>
Factory overheads – factory expenses	1,544,000	
Depreciation on factory building	81,760	
Depreciation on factory plant	<u>326,400</u>	<u>1,952,160</u>
Total cost of production		6,602,160
Add: Opening W.I.P		<u>402,000</u>

		7,004,160	
Less: Closing W.I.P		<u>(536,000)</u>	
Factory cost of finished goods		6,468,160	
Factory profit		<u>923,840</u>	
Finished goods at transfer price		<u>7,392,000</u>	
Sales			12,240,000

Cost of sales

Opening inventory of finished goods		5,368,000	
Finished goods at transfer price		<u>7,392,000</u>	
		12,760,000	
Less: Closing stock of finished goods		<u>(4,608,000)</u>	<u>(8,152,000)</u>
Gross profit			4,088,000
Factory profit			<u>923,840</u>
			5,011,840

Expenses

Decrease in provision for unrealised profit		88,000	
Decrease in provision for bad debts		25,600	
Depreciation of delivery van		205,000	
Office salaries		230,000	
Office expenses add accrued	1,009,000		
Add: Accrued	328,000		
Less: Prepaid	<u>(12,000)</u>	<u>1,325,000</u>	<u>(1,873,600)</u>
Net profit			<u>3,138,240</u>

Profit and Loss Appropriation

Net profit			3,138,240
Add: interest on drawings	A	106,000	
	B	<u>97,400</u>	<u>203,400</u>
			3,341,640
Less: Interest on capital	A	225,000	
	B	<u>250,000</u>	<u>(475,000)</u>
			2,866,640
Less: Salaries	A	100,000	
	B	<u>100,000</u>	<u>(200,000)</u>
Balance shared in PSR			2,666,640
Profit share: Factory	A	1,282,893.5	
Gross	B	<u>1,383,746.5</u>	<u>2,666,640</u>

A and B
Statement of financial position as at 31 March 2004

	COST	DEPRECIATION	NET BOOK VALUE
NON-CURRENT ASSETS			
Freehold factory and land	7,085,000	(3,152,160)	3,935,840
Factory plant	3,264,000	(1,428,000)	1,836,000
Delivery van	<u>820,000</u>	<u>(589,000)</u>	<u>231,000</u>
	<u>11,172,000</u>	<u>5,169,160</u>	6,002,840
CURRENT ASSETS			
Inventory: Raw materials		340,000	
Work in progress		536,000	
Finished goods	4,608,000		
Less unrealised profits	<u>(576,000)</u>	<u>4,032,000</u>	
Receivables	2,176,000		
Less: Provision for bad debts	<u>(217,600)</u>	1,958,400	
Prepaid expenses		32,000	
Bank		<u>113,000</u>	
		7,001,400	
CURRENT LIABILITIES			
Trade payable and other payables	1,390,000		
Accruals	<u>624,000</u>	<u>2,014,000</u>	
Net current assets			<u>4,997,400</u>
NET ASSETS			<u>11,000,240</u>
FINANCED BY:			
Capital	A		4,500,000
	B		<u>5,000,000</u>
			9,500,000
Current accounts	A	761,893.5	
	B	<u>738,346.5</u>	
			<u>1,500,240</u>
			<u>11,000,240</u>
1. Workings: Factory expense			
		1,268,000	
		296,000	
		(20,000)	
		1,544,000	
2. Closing stock of finished goods			
		1,220	
		<u>1,540</u>	
		2,760	
		<u>(1,800)</u>	
		960 units x sh.4,800 = 4,608,000	
3. Unrealized profits			
Factory profit/units produced	923,840/1,540		

$$= \text{Sh.}600 \times 960 \text{ units closing stock}$$

$$= 576,000$$

Or cost of each wheelbarrow produced	=4,800
6,468,160/1,540 units	<u>(4,200)</u>
	Sh.600

4. Factory profit 1/3	307,947		
Gross profit 10%		408,800	
Shared	307,947	408,800	806,747
Balance	<u>974,946.5</u>	<u>947,946.5</u>	1,949,893
	1,282,893.5	1,383,746.5	

1.2 GOODWILL, REVALUATIONS AND LIFE POLICY.

A) GOODWILL

This is defined as “the difference between the value of a business as a whole and the fair value of its net separable assets”.

Goodwill in practical sense is the advantage that an existing business may have over a newly established business. This advantage may be in the form of profits or revenue that the business generates and customer loyalty. Goodwill may arise due to several factors including:

- The location of the business
- The quality of products, services or employees and
- The marketing

In practice, it is normally agreed that many established businesses have created goodwill but unfortunately it is difficult to determine the actual value of goodwill. Therefore, unless goodwill arises from the acquisition of another company, it is normally excluded from the accounts. For the purpose of accounting for partnerships, goodwill is important in the following three main areas.

- When there is a change in the profit sharing ratio
- On admission of a new partner
- On retirement of a partner

i) Change in profit sharing ratio

When there is a change in profit sharing ratio, it means that some of the partners will get higher profits based on the new ratios in the future while others will lose or will get lower profits.

Those who will get higher profits therefore need to pay for the higher profits whereas those who will get lower profits thus need to be compensated for the reduction in their profit share.

To achieve this objective, goodwill is normally introduced in the accounts by crediting the partners capital accounts according to their old profit sharing ratio (PSR) and written off again by debiting the partners capital accounts according to their new PSR.

Example;

A, B and C have been trading as equal partners having capital contributions of £400,000, £300,000 and £200,000 respectively. They decided to change their profit sharing ratio to 3:2:1. Goodwill was agreed at £150,000.

Required:

Prepare their capital accounts to show their new capital balances assuming that goodwill is not to be retained in the accounts.

Capital account							
	A	B	C		A	B	C
Goodwill	75,000	50,000	25,000	Bal. b/d	400,000	300,000	200,000
Bal. c/d	<u>375,000</u>	<u>300,000</u>	<u>225,000</u>	Goodwill	<u>50,000</u>	<u>50,000</u>	<u>50,000</u>
	450,000	350,000	250,000		450,000	350,000	250,000

ii) Admission of a new partner

When a new partner joins the firm/partnership, the new partner will enjoy the benefits arising as a result of goodwill created by the old existing partners. This is because; the new partner will get his share of profits which he may not have received had he decided to start a new business.

It is thus fair that the new partner pays into the firm not only his capital contribution but also his share of the goodwill.

In some situations, the new partner will pay cost directly for his share of goodwill while in most cases, goodwill will be deducted from his total contributions to the business. However, the new partner pays in cash or not for his share of goodwill, the following entries are normally passed in the partners current accounts.

DR. Goodwill
CR. Partners capital accounts (old partners)
 (With the goodwill according to old PSR)

To write off goodwill:

DR. Partners capital accounts (all partners including new one)
CR Goodwill

Goodwill should be debited in partners capital accounts according to the new PSR.

Example:

XYZ have been trading as equal partners having capital contributions of £300,000, £250,000 and £200,000 respectively. They agreed to admit W who agrees to pay capital of £350 which is inclusive of his share of goodwill. The new profit sharing ratio will not be X:Y:Z:W : 4:3:2:1. Goodwill has been agreed at £200,000.

Required:

Prepare the partners capital accounts to record admission of W and assuming that Goodwill is not to be retained in the accounts.

Capital account

	X	Y	X	W		X	Y	Z	W
Goodwill	80	160	40	20	Bal. b/d	300	250	200	-
Bal c/d	286.667	256.667	226.666	330	Goodwill	66.667	66.667	66.666	-
					bank				350
	366.667	316.667	266.666	350		366.667	316.667	226.667	350

iii) Retirement of a partner

When one of the partners retires ante the others will continue trading, the n it is important that he gets a share of the goodwill that he helped create in addition to the total amounts due to him from the partnership.

To ensure that this objective is achieved, the following entries are normally passed in the partners capital accounts.

DR. Goodwill
CR. Partners capital accounts
 (With the value of goodwill to all the partners capital accounts according to old PSR)

To write off the goodwill:

DR. Partners capital accounts
CR. Goodwill
 (With the total value of goodwill and in only capital accounts of remaining partners using new PSR)

To get the total due to a retiring partner, we find out the balance in the current accounts and any loans advanced in the partnership and the balances in these accounts are transferred to the capital accounts.

Incase the partner has retired partway during the financial year, then we update the current account first with the partners share of the profits as per profit and loss appropriation account up to the date of retirement.

The partnership may not have sufficient cash to pay the retiring partner and thus may agree with the retiring partner that his total dues from the partnership be converted into a loan paying a certain interest per annum. However, if the partnership is able to pay the amount due, the retiring partner then the following entry is passed:

DR. Retiring partners capital accounts
Cr. Cash book

Example:

A, B and C have been trading as equal partners having capital contributions of £500,000 and £400,000 and £300,000 respectively as at 1st January 2005. On the same date, B Deared to leave the partnership and A and C were to continue trading as partners sharing profits in the ratio of

2:1. The total amounts due to B could not be paid immediately and thus the remaining partners agreed with B that they will pay 25% of the total due in cash and the balance will be left as a loan earning interest at a rate of 8% per annum.

Meanwhile, goodwill has agreed at £180,000 and B had a credit balance on his current account of £40,000. Goodwill was not to be retained in the books.

Required:

Prepare partners capital accounts record the retirement of B

Capital account							
	A	B	C		A	B	C
Goodwill written off	120,000	-	60,000	Bal. b/d	500,000	400,000	300,000
Cash book	-	125,000	-	Goodwill	60,000	60,000	60,000
8% loan a/c		375,000		Current a/c		40,000	
Bal c/d	<u>440,000</u>	<u>-</u>	<u>300,000</u>				
	560,000	500,000	360,000		<u>560,000</u>	<u>500,000</u>	<u>360,000</u>

Revaluations:

Partners rarely revalue their assets and any revaluations may be carried out when a new partner is being admitted or an old partner is retiring.

To facilitate the process a revaluation account is opened whereby any revaluation gains are credited to the account while revaluation losses are debited to the account. The balance in this account represents a profit or loss on revaluation, which is now transferred or closed off to the partners' capital accounts according to their Profit Sharing Ratio (PSR)

NOTE:

On the profit or loss on revaluation

- i) If the revaluation is carried out when a new partner is being admitted, then the new partner is not entitled to receive any share of the gain nor bear any loss.

Entries for the gain or loss are made only in the old partners' capital accounts according to the old PSR.

- ii) If the revaluation is carried out on retirement of a partner, then the retiring partner is still entitled to a share of profit or loss. Therefore, the gain or loss will be adjusted for in all the partners' capital accounts including the retiring one according to the old PSR.

- iii) In any other situation, e.g. the revaluation is carried out when there is a change in PSR then any gain or loss will be adjusted for in all the partners capital accounts but still the old PSR.

Example

The outline statement of financial position of Scanlon, Winbourne and Guthrie trading as Bentinck Merchants on 31 March 19-5 was:

Bentinck merchants Statement of financial position as at 31 march 19-5			
	£	£	£
Non Current assets			
Premises			30,000
Equipment			7,200
Fixtures and fittings			<u>8,100</u>
			45,300
Current assets			
Inventory		17,800	
Accounts receivables		4,300	
Cash		<u>1,100</u>	
		<u>23,200</u>	
LESS			
Current liabilities			
Accounts payables	6,400		
Bank overdraft	<u>9,700</u>		
		<u>(16,100)</u>	
Working capital			<u>7,100</u>
Net assets			<u>52,400</u>
Financed by			
Capital			
Scanlon			20,000
Winbourne			20,000
Guthrie			<u>10,000</u>
			50,000
Current accounts			
Scanlon		3,600	
Winbourne		(2,100)	
Guthrie		<u>900</u>	
			<u>2,400</u>
			<u>52,400</u>

Up to this date the partners had shared profits and losses equally, it had been agreed, however, that from 1 April 19-5 this would change to Scanlon $\frac{1}{2}$ Winbourne $\frac{1}{3}$ Guthrie $\frac{1}{6}$. At the same time the assets were revalued at the following amounts.

Premises	£ 55,000
Equipment	6,000
Fixtures & fittings	8,000
Inventory	16,500
Accounts receivables	4,100
Goodwill	12,000

Required

Prepare the Revaluation and capital accounts and statement of financial position on the assumption that the above revaluations are to be retained in the books of Bentinck Merchants but goodwill is to be written off.

Solution**Capital account**

	Scanlon	Winbourne	Guthrie		Scanlon	Winbourne	Githrie
Goodwill written off	6,000	4,000	2,000	Bal b/d	20,000	20,000	10,000
Bal c/d	25,400	27,400	19,400	Goodwill	4,000	4,000	4,000
	<u>31,400</u>	<u>31,400</u>	<u>21,400</u>	Revaluation gain	<u>7,400</u>	<u>7,400</u>	<u>7,400</u>
					31,400	31,400	21,400

Revaluation a/c

Fixtures and fittings	100	Premises	25,000
Equipment	1,200		
Inventory	1,300		
Account receivables	200		
Capital accounts	<u>22,200</u>		
	<u>25,000</u>		<u>25,000</u>

BENTINCK MERCHANTS**Statement of financial position as at 31 March 19-5**

	£	£	£
NON-CURRENT ASSETS			
Premises			55,000
Equipment			6,000
Fixtures and fittings			<u>8,000</u>
			69,000
CURRENT ASSETS			
Inventory		16,500	
Accounts receivables		4,100	
Cash		<u>1,100</u>	
		21,700	
CURRENT LIABILITIES			
Account payables			
Bank overdraft	6,400		
Net current assets	<u>9,700</u>	<u>(16,100)</u>	<u>5,600</u>
NET ASSETS			<u><u>74,600</u></u>
FINANCED BY			
Capital: Scanlon			25,400
Winbourne			27,400
Gulthrie			<u>19,400</u>
			72,200
Current accounts: Scanlon		3,600	
Winbourne		(2,100)	
Gulthrie		<u>900</u>	
			<u>2,400</u>
			<u><u>74,600</u></u>

SURVIVORSHIP POLICY

The partners may take out a survivorship policy to safeguard against future cashflow problems in case a partner dies or the business is dissolved. E.g. in case a partner dies, then the remaining partners may wish to continue business but they may experience cashflow problems because they have to pay the estate of the deceased partner.

On dissolution, again the partners may not be able to sell off all the assets on time and thus pay off the creditors.

Therefore, under a survivorship policy the insurance will pay the partners the sum assured on the death of a partner or the surrender value when the policy is terminated because the business is being dissolved.

The premiums paid on such a policy may be treated in several ways.

1. As an asset

The argument for this statement is that the survivorship policy is an investment because eventually the partnership will receive either the surrender value or the sum assured and thus the premium should not be expensed but carried as an asset.

Relevant entries

DR. Life policy asset account
CR. Cash book

2. As an expense and an asset

This approach tries to resolve the differences between the two methods by ensuring that we show an asset that may materialize or crystallize and at the same time we charge an expense in the profit and loss for the premium.

A new account called **life policy fund** is normally set up to facilitate the process.

Relevant entries are:

DR. Life policy asset account
CR. Cash book

DR. Profit and loss
CR. Life policy fund account
(With the premium paid for both of the two journal entries)

At the end of the financial period, the life policy asset account and fund account are normally adjusted to reflect the surrender value. The asset and fund account must be equal but directly opposite and in case the surrender value is higher than the premiums (total) paid to date are:-

DR. Life Policy asset account
CR. Life Policy fund account
(With the difference)

When the insurance company pays the sum assured or surrendered value, then we:

DR. Cash book
CR. Life Policy asset account

The life policy fund account should be closed off to the partners capital accounts according to their profit sharing ratio.

1.3 ADMISSIONS AND RETIREMENTS

The major focus on admission or retirement involves making adjustments for goodwill as discussed above. The next section will just deal with illustrative examples.

Example

Jim and Ken have been trading in partnership for several, sharing profits or losses equally after allowing for interest on their capitals at 8% p.a. At 1 September 19-7 their manager, Len, was admitted as a partner and was to have a one-fifth share of the profits after interest on capital. Jim and Ken shared the balance equally but guaranteed that Len's share would not fall below £6,000 p.a. Len was not required to introduce any capital at the date of admission but agreed to retain £1,500 of his profit

share at the end of each year to be credited to his capital account until the balance reached £7,500, until that time no interest was to be allowed on his capital. Goodwill, calculated as a percentage of the profits of the last five years was agreed at £15,000 at September 19-7, and Len paid into the business sufficient cash for his share. No goodwill accounts were to be left in the books. Land and building were professionally valued at the same date £28,400 and this figure was to be brought into the books, whilst the book value of the equipment and vehicles was, by mutual agreement, to be reduced to £15,000 at the date. Len had previously been entitled to a bonus of 5% of the gross profit payable half-yearly, the bonus together with his manager's salary were cease when he became a partner. It was agreed to take out a survivorship policy and the first premium of £1,000 was paid on 1 September 19-7.

The trial balance at the end of the 19-7 financial year is given below. No adjustments had yet been made in respect of lens admission, and the amount he introduced for goodwill had been put into his current account. The drawings of all the partners have been changed to their current account. It can be assumed that the gross profit and trading expenses accrued evenly throughout the year. Depreciation on the equipment and vehicles is to be charges at 20% p.a. on the book value.

	£	£
Capital accounts Jim		30,000
Ken		15,000
Current accounts Jim	7,800	
Ken	7,100	
Len		1,800
Land and buildings	18,000	
Equipment and vehicles	21,000	
Inventory	9,200	
Gross profit		42,000
Trading expenses	15,000	
Managers salary	4,000	
Managers bonus	1,050	
Accounts receivables & Payables	4,850	3,100
Premium on survivorship policy	1,000	
Bank balance	<u>2,900</u>	
	<u>91,900</u>	<u>91,900</u>

Required:

(a) Prepare the income statement and the partner's capital and current accounts for the year ended 31 December 19-7 and statement of financial position as at that date.

Solution

Capital account

	JIM	KEN	LEN		JIM	KEN	LEN
Goodwill written off	6,000	6,000	3,000	Bal b/d	30,000	15,000	-
				Current a/c – capital	-	-	15,000
				Goodwill	7,500	7,500	-
				Current a/c – goodwill	-	-	3,000
Bal c/d	35,100	20,100	1,500	Revaluation gain	3,600	3,600	-
	<u>41,100</u>	<u>26,100</u>	<u>4,500</u>		<u>41,100</u>	<u>26,100</u>	<u>4,500</u>

Current account

	JIM	KEN	LEN		JIM	KEN	LEN
Balance b/d	7,800	7,100	-	Balance b/d	30,000	15,000	-
Capital a/c –capital	-	-	1,500	Accrued bonus	-	-	1,500
Capital a/c-goodwill	-	-	3,000	Interest on capital	7,500	7,500	-
Balance c/d	200			Profit share	-	-	3,000
				Balance c/d	3,600	3,600	-
	<u>8,000</u>	<u>7,100</u>	<u>4,500</u>		<u>8,000</u>	<u>7,100</u>	<u>4,500</u>

Revaluation account

Equipment and vehicles		3,200	Land and building	10,400
Capital account – JIM	3,600			
KEN	3,600	<u>7,200</u>		
		<u>10,400</u>		<u>10,400</u>

Jim, Ken and Len

Partnership, Profit and Loss and Appropriation account
For the year ended 31 December 19-7

	1 st 8 months		2 nd 4 months		TOTAL	
	£	£	£	£	£	£
Gross profit		28,000		14,000		42,000
Expenses						
Depreciation on equipment & vehicles	2,800		1,000		3,800	
Trading expenses	10,000		5,000		15,000	
Managers' salary	4,000		-		4,000	
Manager bonus	1,400		-		1,400	
Premium on survivorship policy	-	(18,200)	1,000	(7,000)	1,000	(25,200)
NET PROFIT		9,800		7,000		16,800
Less: Interest on capital J	1,600		936		2,536	
K	800		536		1,336	
L	=	(2,400)	=	(1,472)	=	(3,872)
Balance of profits share in PSR		7,400		5,528		12,928
J	3,700		1,764		5,464	
K	3,700		1,764		5,464	
L	=	(7,400)	2,000	(5,528)	2,000	(12,928)

Jim, Ken and Len Partnership

Statement of financial position as at 31 December 19-7

	Cost revaluation	Depreciation to date	Net book value
NON-CURRENT ASSETS			
Land and buildings	28,400	-	28,400
Equipment and vehicles	<u>15,000</u>	<u>(1,000)</u>	<u>14,000</u>
	<u>43,400</u>	<u>(1,000)</u>	<u>42,400</u>

Life policy asset account		<u>1,000</u>
		43,400

CURRENT ASSETS

Inventory	9,200	
Account receivables	4,850	
Bank	<u>2,900</u>	
	16,950	

CURRENT LIABILITIES

Trade payables	<u>(3,100)</u>	
Net current assets		<u>13,850</u>
		<u>57,250</u>

FINANCED BY:

Capital: J		35,100
K		20,100
L		<u>1,500</u>
		56,700

Current account J	200	
K	(300)	
L	<u>(350)</u>	(450)
Life policy fund account		<u>1,000</u>
		<u>57,250</u>

Example 2

Kijiko and Sahani, who prepare their accounts annually to 30 September, are partners in retail business sharing profits and losses in the ratio of 3:2 respectively.

On 31 March 2003, Kijiko retired and Mwiko was admitted as a partner, profits and losses from that date being shared between Sahani and Mwiko in the ratio of 2:1 respectively. For the purpose of these changes, the value of the firm's goodwill was agreed at Sh. 900,000. No account for goodwill is maintained in the books, adjusting entries for the transactions between the partners being made in their current accounts.

Interest on fixed capitals is allowed at 6% per annum but no interest is charged or allowed on current accounts. The amount due to a retiring partner is payable as to Sh. 250,000 on retirement, the balance being payable in five equal annual instalments commencing on the first anniversary of his retirement. The amount due to retiring partner attracts interest at the rate of 8% per annum.

The trial balance of the partnership as at 30 September 2003 was as follows:

	Sh. "000"	Sh. "000"
Leasehold premises (bought on 1 October 2002)	800	
Purchases	2,040	
Motor vehicles at cost (30 September 2002)	420	
Provision for depreciation – motor vehicles (30 September 2002)		180
Shop fittings at cost (30 September 2002)	180	
Provision for depreciation – shop fittings (30 September 2002)		60
Balance at bank	148	
Salaries	640	

Stock (30 September 2002)	510	
Sales (Sh. 1,393,300 for six months to 31 March 2003)		3,800
Cash paid to Kijiko	250	
Debtors	80	
Creditors		360
Professional charges	54	
Wages	380	
Rates and lighting	168	
General expenses (Sh. 172,000 for six 31 March 2003)	410	
Cash introduced by Mwiko		400
Capital accounts: - Kijiko		500
- Sahani		300
Current accounts: - Kijiko		220
- Sahani		260
	<u>6,080</u>	<u>6,080</u>

Additional information:

- It was agreed that of the Sh. 400,000 introduced into the firm by Mwiko on 1 April 2003, Sh. 100,000 should form his fixed capital, the balance being credited to his current account
- The stock as at 30 September 2003 was valued at Sh. 560,000.
- Provision is to be made for depreciation on motor vehicles and shop fittings at the rates of 20% per annum and 10% per annum respectively on cost at the end of the year.
- A motor vehicle which had cost Sh. 120,000 and on which depreciation of Sh. 48,000 had been provided, was taken over by Kijiko on his retirement at its down value.
- The following drawings by partners are included in salaries:

	Sh. "000"
Kijiko	60
Sahani	40
Mwiko	20

- As at 30 September 2003, rates paid in advance amounted to Sh. 22,000 and provision of Sh. 8,000 for general expenses was required.
- A difference in the books of accounts of Sh. 10,000 had been written off at 30 September 2003 to general expenses but had later been found to be due to an undercast of similar amount in the purchases journal
- Professional charges include Sh. 20,000 paid in respect of the acquisition of the leasehold premises. The total cost of the lease is to be written off over a period of 50 years.

Required:

- The income statement for the year ended 30 September 2003, (Gross profit is to be apportioned on the basis of turnover. Unless otherwise indicated, expenses are to be apportioned on a time basis). (10 marks)
- The partner's current accounts as at 30 September 2003. (4 marks)
- The statement of financial position as at 30 September 2003. (6 marks)

(Total: 20 marks)

Solution

Kijiko, Sahani and Mwiko Partnership
Income statement for the year ended 30/9/2003

	1 st 6 months		2 nd 6 months		TOTAL	
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
Sales						3,800
Cost of sales						
Opening inventory					510	
Purchases					<u>2,050</u>	
					2,560	
Closing inventory					<u>(560)</u>	(2,000)
Gross profit		660		1,140		1,800
Expenses						
Depreciation on motor vehicles	42		30			72
Amortization of lease	8.2		8.2			16.4
Depreciation on fittings	9		9			18
Salaries	260		260			520
Professional charges	17		17			34
Wages	190		190			380
Rates and lighting	73		73			146
General expenses	172		236			408
Interest on loan by K	—	<u>(771.2)</u>	<u>33</u>	<u>(856.2)</u>	<u>33</u>	<u>(1,627.4)</u>
NET LOSS		<u>(111.2)</u>		<u>283.8</u>		<u>172.6</u>
Less: interest on capital: K	15		-		15	
S	9		9		18	
M	—	<u>(24)</u>	<u>3</u>	<u>(12)</u>	<u>3</u>	<u>(36)</u>
Share of loss/profit in PSR		<u>(135.2)</u>		<u>271.8</u>		<u>136.6</u>
K	<u>(81.12)</u>		-		<u>(81.12)</u>	
S	<u>(54.08)</u>		181.2		<u>127.12</u>	
M	—	<u>(135.2)</u>	<u>90.6</u>	<u>271.8</u>	<u>90.6</u>	<u>136.6</u>

Current account

	K	S	M		K	S	M
Goodwill written off		600	300	Balance b/d	220	260	-
Loss share	81.12		-	Interest on capital	15	18	3
Drawings	60	40	20	Goodwill	540	360	-
				Bank – capital	-	-	300
				Profit share		127.12	90.6
Balance c/d	633.88	125.12	73.6	Balance c/d			
	<u>775</u>	<u>765.12</u>	<u>393.6</u>		<u>775</u>	<u>765.12</u>	<u>393.6</u>

Capital account

	K	S	M		K	S	M
Motor vehicle	60	-	-	Balance b/d	500	300	-
Bank	250	-	-	Bank (capital)	-	-	100
Loan	823.88	-	-	Current account	633.88	-	-
Balance c/d	-	300	100				
	<u>1,13.88</u>	<u>300</u>	<u>100</u>		<u>1,133.88</u>	<u>300</u>	<u>100</u>

SAHANI AND MWIKO PARTNERSHIP

Statement of financial position as at 30 September 2003

NON-CURRENT ASSETS

	COST	DEPRECIATION	NET BOOK VALUE
	Shs 000	Shs 000	Shs000
Leasehold premises	820	(16.4)	803.6
Motor vehicles	300	(192)	108
Shop fittings	<u>180</u>	<u>(78)</u>	<u>102</u>
	<u>1,300</u>	<u>286.4</u>	1,013.6

CURRENT ASSETS

Inventory	560
Debtors	80
Prepayments	22
Bank	148
	810

CURRENT LIABILITIES

Payables	360		
Accruals – general expenses	8		
Accrued (due to K)	<u>197.776</u>	<u>(565.776)</u>	
Net current assets			<u>244.244</u>
NET ASSETS			<u>1,257.824</u>

FINANCED BY:

Capital: Sahani			300
Mwiko			<u>100</u>
			400
Current: Sahani	125.12		
Mwiko	<u>73.6</u>		<u>198.72</u>
			598.72

NON-CURRENT LIABILITIES

Loan to K			<u>659.104</u>
			<u>1,257.824</u>

Workings:

	'000'
General expenses	
As per trial balance	410
Less: Purchases add general accrued (8)	(10)
	408
1 st 6 months	(172)
	236

1.4 DISSOLUTIONS

A partnership may be dissolved due to various reasons which include:

- i) Poor trading that has led to losses
- ii) A partner dying or leaving the firm
- iii) The time period for which the partnership was formed has elapsed.

The main objective of accounting for dissolutions is to ensure that the dissolution transactions are recorded properly. These transactions involve;
Selling the assets of the business and thereafter paying off dissolution expenses and liabilities of the partnership. The remaining costs are now paid off to the partners.

In the process of selling off the assets, the assets may be sold off at a profit or loss this profit or loss is supposed to be shared by the partners according to the profit sharing ratio before the final payments are made to them.

To facilitate the process of dissolution, a new account called realization account in which the assets being sold are transferred and the cash proceeds received on the sale of the assets. Generally, the realization account is supposed to record all profits or losses in return to dissolution and therefore dissolution expenses will also be posted here discounts received from creditors, and also discounts allowed to debtors.

The balance on the realization account is the profit or loss on dissolution that is closed off to the capital accounts.

The following journal entries are relevant for the purpose of recording all dissolutions:

1. DR.Revaluation account
CR. Asset account
(With the book value of the assets being sold / or being realized)
2. DR.Cash book
CR. Realisation account
(With the cash received on the assets being realized)
3. DR.Realisation account
CR. Cash book
(With the dissolution expenses paid)
4. DR.Creditors account payables

- CR. Cash book
(With payment made to the creditors)
5. DR. Creditors
CR. Realization account
(With the discount received from account payable or creditors)
6. Dr. Realization account
CR. Capital accounts
(With the profit on realization being the balancing figure and according to P/SR)
Incase it is a loss, then the entries are received.
7. DR. Current account
CR. Capital accounts
(To transfer the accounts due to the partners on their current accounts to the capital account)
8. DR Capital accounts
CR. Cash book
(To close off the capital accounts with the cash book)

There are two situations that need to be considered under dissolutions. These are:-

- i) Where the assets are sold at once (one single transaction)
 - ii) Assets are sold on piece meal basis.
-
- i) Where assets are sold off at once

Under this situation, the partners are able to get a single buyer who buys all the assets in a single transaction. The buyer could be an individual, sole trader, another partnership or a company. This kind of situation is straightforward because the partners can be able to determine profit or loss on dissolution immediately.

Example:

X, Y and Z have been trading as partners sharing profits and losses in the ratio of 2:2:1 on the 1st July 2005, they decided to dissolve the partnership and all the assets were sold in a single transaction in the market. The statement of financial position as at 1st July 2005 was as follows:

X, Y and Z
Statement of financial position as at 1.7.2005

	£	£
NON-CURRENT ASSETS		
Freehold property		60,000
Equipment		<u>30,000</u>
		90,000
CURRENT ASSETS		
Inventory	16,000	
Account receivables	9,000	
Cash at bank	<u>4,200</u>	
	29,200	

CURRENT LIABILITIES

Account payables	(6,000)	
Net current assets		<u>23,200</u>
NET ASSETS		<u>113,200</u>

FINANCED BY:

Capital accounts	X		78,000
	Y		26,000
	Z		<u>4,000</u>
			108,000

Current accounts	X	1,400	
	Y	(600)	
	Z	<u>400</u>	
			<u>1,200</u>
			109,200

NON-CURRENT LIABILITIES

Loan from bank	3,000	
Loan from Y	<u>1,000</u>	<u>4,000</u>
		<u>113,200</u>

The current assets sold on the market fetched the following assets:

Freehold property	£	62,000
Equipment		9,600
Inventory		5,800

The receivables paid their amounts in full while payables gave discounts of £200. The dissolution amounts to £1600.

Required:

Prepare the relevant accounts to record the dissolution.

Solution

Realization account			
	£		£
Freehold property	60,000	Cash book equipment	9,600
Equipment	30,000	Property	6,200
Inventory	16,000	Inventory	8,800
Debtors	9,000	Debtors	9,000
Cash book dissolution expenditure	1,600	A/c payables discounts	200
		Loss on dissolution	X
			12,000
			Y
			12,000
			Z
			<u>6,000</u>
	<u>116,600</u>		<u>116,600</u>

Cash book account

	£		£
Balance b/d	4,200	Realizable dissolution expense	1,600
Realisation – equipment	9,600	Accounts payables	5,800
Freehold property	62,000	Loan from bank	3,000
Inventory	5,800	Loan from Y	7,000
Accounts receivables	9,000	Capital X	67,400
Capital account Z	<u>1,600</u>	Y	<u>13,400</u>
	<u>92,200</u>		<u>92,200</u>

Capital account

	X	Y	Z		X	Y	Z
	£	£	£		£	£	£
Realisation account – loss	12,000	12,000	6,000	Bal b/d	78,000	26,000	4,000
Current account	-	600	-	Current account	1,400	-	400
Cash book (bal. Fig)	<u>67,400</u>	<u>13,400</u>	<u> </u>	Cash book (Bal. Fig)	<u> </u>	<u> </u>	<u>1,600</u>
	<u>79,400</u>	<u>26,000</u>	<u>6,000</u>		<u>79,400</u>	<u>26,000</u>	<u>6,000</u>

In the current example, we have assumed that partner Z is solvent and therefore he is in a position to bring in the cash required from him so that full distribution is made to the other partners.

However, in certain situations, a partner/some partners may not be able contribute the additional cash required and thus they are said to be **insolvent**.

According to the rule in **Gurner V. Murray**, if some of the partners are insolvent, then their loss appearing in the capital balances should be borne by the solvent partners according to the **initial capital balances** (and NOT their Profit Sharing Ratio)

In the given example therefore, if we assume that Z is insolvent, and will therefore not be in a position to contribute the £1,600 due from him, then it will be shared between X and Y in the ratio of 78,000:26,000.

Capital account

	X	Y	Z		X	Y	Z
	£	£	£		£	£	£
Realisation account – loss	12,000	12,000	6,000	Bal b/d	78,000	26,000	4,000
Current account	-	600	-	Current account	1,400	-	400
Contra - Z	1,200	400	-	X			1,200
Cash book	<u>66,200</u>	<u>13,000</u>	<u> </u>	Y			<u>400</u>
	<u>79,400</u>	<u>26,000</u>	<u>6,000</u>		<u>79,400</u>	<u>26,000</u>	<u>6,000</u>

These balances transferred to the cash book shall change i.e. be different from the previous one.

If the rule in **Guvner V. Murray** is excluded as per requirements of the examiner, then the loss or balance due from the insolvent partner will be shared by the remaining solvent partners according to the profit sharing ratio.

In the given example, therefore, if the rule in **Guvner V. Murray** was excluded, then the loss of £1,600 due from Z would be shared in the ratio of 2:2 by X and Y i.e. £800 and £800.

The partners may sell off the assets of the partnership to a company and instead of being paid by cash the purchase consideration may be made up of shares or loan stock. The purchase consideration may have a combination of several items i.e. shares (ordinary and preference), loan stock and balance in form of cash.

The determination of profit or loss on Realisation will be done the same way as before and instead of only the cash being credited in the Realisation account, we may also have the shares and loan stock issued to the partners.

A separate account may be opened for the ordinary shares and the loan stock issued and the following entry will be passed.

DR. Loan stock or shares
CR. Realisation account
 (With the value of the shares and the loan stock issue)

once we determine how much is due to the partners, then the shares and the loan stock account will be closed off as follows:

DR. Capital accounts
CR. Shares or loan stock accounts
 (With the amounts due to each of the partners)

In most cases, the shares and loan stock may be issued to the partners according to some agreed ratio and any balances remaining in the partners capital accounts will be settled by way of cash.

Example

Amis, Lodge and Pym were in partnership sharing profits and losses in the ratio 5:3:2. The following trial balance has been extracted from their books of account as at 31st March 19-8:

Bank interest received	£	£
Capital accounts (as at 1 April 19-7)		750
Amis		80,000
Lodge		15,000
Pym		5,000
Carriage inwards	4,000	
Carriage outwards	12,000	
Cash at Bank	4,900	
<i>Current accounts</i>		
Amis	1,000	
Lodge	500	

Pym	400	
Discounts allowed	10,000	
Discounts received		4,530
Drawings:		
Amis	25,000	
Lodge	22,000	
Pym	15,000	
Motor vehicles		
at cost	80,000	
Accumulated depreciation (at 1 April 19-70)		20,000
Office expenses	30,400	
Plant and machinery		
At cost	100,000	
Accumulated depreciation (at 1 April 19-7)		36,600
Provision for bad debts (at 1 April 19-7)		420
Purchases	225,000	
Rent, rates, heat and light	8,800	
Sales		404,500
Inventory (at 1 April 19-7)	30,000	
Trade payables		16,500
Trade receivables	<u>14,300</u>	
	<u>£583,300</u>	<u>£583,300</u>

Additional information:

- Inventory as at 31 March 19-8 was valued at £5,000;
- Depreciation is to be charged as follows:
 - Motor vehicles- 25% on the reduced balance
 - Plant and machinery -20% on the original cost

There were no purchases or sales of property, plant and equipment during the year to 31 March 19-8.

- The provision for bad and doubtful debts is to be maintained at a level equivalent to 5% of the total trade debtors as at 31 March 19-8
- An office expense of £405 owed at 31st March 19-8, and some rent amounting to £1,500 had been paid in advance as at that date. These items had not been included in the list of balances shown in the trial balance.
- Interest on drawings and on the debit balance on each partner's current account is to be charged a follows:

	£
Amis	1,000
Lodge	900
Pym	720

6. According to the partnership agreement, Pym is allowed a salary of £13,000 per annum. This amount owed to Pym for the year to 31 March 19-8, and needs to be accounted for.
7. The partnership agreement also allows each partner interest on his capital account at a rate of 10% per annum. There were no movements on the respective partners' accounts during the year to 31 March 19-8, and the interest had not been credited to them about that date.

Note: The information given above is sufficient to answer part a) i) and ii) of the question, and notes 8) and 9) below are pertinent to requirements b) i) and ii) of the question.

8. On 1 April 19-8 Fowles Limited agreed to purchase the business on the following terms:
 - a) Amis to purchase one of the partnership's motor vehicles at an agreed value of £30,000;
 - b) The company agreed to purchase the plant and machinery at a value of £ 35,000 and the stock at a value of £ 38,500;
 - c) The partners to settle the trade payables; the total amount agreed with the creditors being £16,000;
 - d) The trade receivables were not to be taken over by the company, the partners receiving cheques on 1 April 19-8 amounting to £12,985 in total from the trade debtors in settlement of the outstanding debts;
 - e) The partners paid the outstanding office expenses on 1 April 19-8, and the landlord returned the rent paid in advance by cheque on the same day;
 - f) As consideration for the sale of the partnership, the partners were to be paid £63,500 in cash by Fowles Limited, and to receive 75,000 in £1 ordinary shares in the company, the shares to be apportioned equally amongst the partners;
- 9) Assume that all the matters relating to the dissolution of the partnership and its sale to the company took place on 1 April 19-8.

Required

- a) Prepare:
 - i. Amis, Lodges and Pym's trading, profit and loss appropriations account for the year to 31 March 19-8;

And

- ii. Ami's, Lodge's and Pym's current accounts (In Columna format) for the year to 31 March 19-8 (the final balance on each account is to be then transferred to each partner's respective capital account
And

- b) Compile the following accounts:

- i. The partnership realization account for the period up to and including 1 April 19-8;
- ii. The partner's bank account for the period up to and including 1 April 19-8;
and
- iii. The partner's Capital accounts (in column format) for the period up to and including 1 April 19-8.

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Solution

**Amis, Lodge and Payne
Trading, Profit and Loss account**

	£	£	£
Sales			404,500
Cost of sales			
Opening stock		30,000	
Purchases	225,000		
Add carriage in	<u>4,000</u>	<u>229,000</u>	
		259,000	
Closing stock		<u>(5,000)</u>	<u>(254,000)</u>
Gross profit			150,500
Bank interest received		750	
Discount received		<u>4,350</u>	<u>5,280</u>
			155,780
Expenses			
Increase in provision for bad debts		295	
Carriage outwards		12,000	
Discount allowed		10,000	
Depreciation on plant		20,000	
Depreciation on motor vehicles		15,000	
Office expenses	30,400		
Add accrued	<u>405</u>	30805	
Rent, rates, light and heating	8,800		
Less prepaid	<u>(1,500)</u>	<u>7,300</u>	<u>95,400</u>
NET PROFIT			60,380
ADD: Interest on drawings: Amis		1,000	
Lodge		900	
Payne		<u>720</u>	<u>2,620</u>
			63,000
Less Interest on capital: Amis		8,000	
Lodge		1,500	
Payne		<u>500</u>	<u>(10,000)</u>
			53,000
Salaries to Payne			<u>(13,000)</u>
Profit shared in PSR			40,000
Amis		20,000	
Lodge		12,000	
Payne		<u>8,000</u>	<u>(40,000)</u>
			-

Amis, Lodge and Payne
Statement of financial position as at 1st April 19-8

	COST	DEPRECIATION	NET BOOK VALUE
NON-CURRENT ASSETS			
	£	£	£
Property and plant	100,000	(56,600)	43,400
Motor vehicles	<u>80,000</u>	<u>(35,000)</u>	<u>45,000</u>
	180,000	91,600	88,400
CURRENT ASSETS			
Inventory		5,000	
Receivables	14,300		
Less provision for bad debts	<u>(715)</u>	13,585	
Prepayments		1,500	
Cash at bank		<u>4,900</u>	
		24,985	
CURRENT LIABILITIES			
Payables	16,500		
Accruals	405	<u>(16,905)</u>	
Net current assets			<u>8,080</u>
NET ASSETS			<u>96,480</u>
FINANCED BY			
Capital accounts: Amis			80,000
Lodge			15,000
Payne			<u>5,000</u>
			100,000
Current accounts: Amis		3,000	
Lodge		(1,900)	
Payne		<u>5,380</u>	<u>(3,520)</u>
			<u>96,480</u>

Current account

	Amis	Lodge	Payne		Amis	Lodge	Payne
	£	£	£		£	£	£
Balance b/d	1,000	500	400	Interest on capital	8,000	1,500	500
Drawings	25,000	22,000	15,000	Salary			13,000
Interest on drawings	1,000	900	720	Profit share	20,000	12,000	8,000
Balance c/d	<u>1,000</u>	<u> </u>	<u>5,380</u>	Balance c/d	<u> </u>	<u>9,900</u>	<u> </u>
	<u>28,000</u>	<u>23,400</u>	<u>21,500</u>		<u>28,000</u>	<u>23,400</u>	<u>21,500</u>

Cash book account

Balance b/d	£ 4,900	Creditors	£ 16,000
Realisation account dep	12,985	Accrued expenses	405
Realisation account prep	1,500	Capital accounts A	63,500
Realisation from company	63,500	L	2,600
		P	380
	<u>82,885</u>		<u>82,885</u>

Realization account

Plant and equipment	£ 43,400	Capital account – A	£ 30,000
Motor vehicle	45,000	Creditors discount	500
Inventory	5,000	Cash book account – received	12,985
Debtors	13,585	Cash book prepayment	1,500
Prepayments	1,500	Cash book	63,500
Capital accounts		Ordinary shares	75,000
Profit share A	375,000		
L	225,000		
P	<u>15,000</u>		
	<u>183,485</u>		<u>183,485</u>

Capital account

	Amis	Lodge	Payne		Amis	Lodge	Payne
	£	£	£		£	£	£
Realization	36,000	-	-	Balance b/d	80,000	15,000	5,000
Current accounts	-	9,900	-	Realisation a/c	37,500	22,500	15,000
Ordinary share	25,000	25,000	25,000	Current a/c	1,000	-	5,380
Cash book	<u>63,500</u>	<u>2,600</u>	<u>380</u>				
	<u>118,500</u>	<u>37,500</u>	<u>25,380</u>		<u>118,500</u>	<u>37,500</u>	<u>25,380</u>

Ordinary share capital account

Realization	£ 75,000	Capital account A	£ 25,000
		L	25,000
		M	<u>25,000</u>
	<u>75,000</u>		<u>75,000</u>

Piecemeal Realizations and Distributions

Partnership dissolutions may take a substantial number of days (even months) so it is unlikely that all cash generated will be simultaneous, unless the business is sold off as a going concern, i.e. a single unit.

The partners may not be willing to wait for such long durations for the process to be complete before receiving their repayments of capital.

It is therefore common practice to make interim distributions to partners as soon as a reasonable amount of cash is available. However, all liabilities must have been paid off by the time any distribution is made to a partner.

These interim distributions give rise to two problems:

- i) Partners have not always contributed capitals in the same ratio as that in which they share profits;
- ii) There will always be uncertainty of future realizations

These two problems point in the same direction: how does one pay cash to partners in such amounts that the partner will never be asked to return any at a later date as excess?

The distribution has to be made in such a way each partner only receives cash after considering all possible gains and losses attributable to that partner at that stage. Two methods have been developed to accomplish this;

- i) The maximum possible loss method
- ii) The surplus capital method

The maximum possible loss method

Under this method, a table is set up to compute the amounts payable to each partner. The results of the computation may be then posted into the capital and other relevant accounts. The computation works on the basis that capital accounts take the following form:

Capitals					
	Sh	Sh		Sh	Sh
Cashbook	X	X	Bal b/d	X	X
Realisation loss	X	X			
	<u>XX</u>	<u>XX</u>		<u>XX</u>	<u>XX</u>

Therefore: Capital – Cash = Realisation Loss

OR

Capital – Realisation Loss = Cash to be paid.

The table takes the following form: [Assume 3 partners A, B and C].

Schedule of distribution					
	Total	A	B	C	Distribution
Capitals	X	X	X	X	
Available cash	<u>(X)</u>				
Maximum possible loss	<u>X</u>	<u>(X)</u>	<u>(X)</u>	<u>(X)</u>	
		<u>XX</u>	<u>XX</u>	<u>XX</u>	<u>XX</u>

In the initial stages, the cash received may be little, and this may result in a large 'Maximum possible loss'. When this is divided amongst partners in profit sharing ratio and deducted from capitals, the resultant figure is negative (same as a debit in the capital account – see illustrations 6 & 7). Assuming a maximum possible loss situation, the partner with a negative figure will be deemed bankrupt, and the negative figure uncollectible. This will be divided amongst the other partners in profit sharing ratio or the ratio in which capitals are held. It will depend upon whether the ruling in Garner Vs Murray is to be excluded or applied. Whichever the case, the table will now take the following form:

Schedule of distribution

	Total	A	B	C	Distribution
Capitals	X	X	X	X	
Available cash	<u>(X)</u>				
Maximum possible loss	X	<u>(X)</u>	<u>(X)</u>	<u>(X)</u>	
		X	X	X	
		<u>XX</u>	<u>XX</u>	<u>XX</u>	<u>XX</u>

It is important to realize that the loss in the table is not real; it will only become real if no further cash is collected. The loss is only for the cash collected this far.

Illustration 8

XYZ
Statement of financial position

	Sh		Sh
Freehold property	30,000	Capitals: X	40,700
Equipment	<u>15,000</u>	Y	13,700
	<u>45,000</u>	Z	5,200
Stock	8,000		
Debtors	4,500		
Bank	<u>2,100</u>		
	<u>14,600</u>		
	<u>59,600</u>		<u>59,600</u>

This is the statement of financial position of X, Y and Z who are sharing profits and losses in the ratio 2:2:1 immediately prior to dissolution.

The partners were unable to sell the business as a going concern and disposed of the assets separately for the following sums:

Freehold property	Sh 28,900
Equipment	Sh 5,300
Stock	Sh 2,400

Debtors paid their dues in full (after the sale of stock) and dissolution expenses totaled Ksh 700. These were paid on the last day, after collections from debtors.

Required:

- i) A distribution schedule (also known as statement of distribution) assuming the application of the ruling in Garner Vs Murray is required;
- ii) Ledger accounts to record the dissolution.

Statement of distribution

	Total Sh	X (Sh)	Y (Sh)	Z (Sh)	Total Amount Distribution (Sh)
Capitals	59,600	40,700	13,700	5,200	
Available cash	(31,000)				
Maximum possible loss	<u>28,600</u>	<u>(11,400)</u>	<u>(11,440)</u>	<u>(5,720)</u>	
		<u>29,260</u>	<u>2,260</u>	<u>(520)</u>	
Reapportionment of z's balance		<u>(389)</u>	<u>(131)</u>	<u>520</u>	
		<u>28,871</u>	<u>2,129</u>	<u>-</u>	<u>31,000</u>
Capitals	28,600	11,829	11,571	5,200	
Available cash	(5,300)				
Maximum possible loss	<u>23,300</u>	<u>(9,320)</u>	<u>(9,320)</u>	<u>(4,660)</u>	
		<u>2,509</u>	<u>2,251</u>	<u>(540)</u>	<u>5,300</u>
Capitals	23,300	9,320	9,320	4,660	
Available cash	(2,400)				
Maximum possible loss	<u>20,900</u>	<u>(8,360)</u>	<u>(8,360)</u>	<u>(4,180)</u>	
		<u>960</u>	<u>960</u>	<u>480</u>	<u>2,400</u>
Capitals	20,900	8,360	8,360	4,180	
Available cash	(3,800)				
	<u>17,100</u>	<u>6,840</u>	<u>6,840</u>	<u>3,420</u>	
		<u>1,520</u>	<u>1,520</u>	<u>760</u>	<u>3,800</u>

Tutorial notes and workings:

1) In the first table:

- i) Available cash was arrived at by:

Cash at bank	Sh 2,100
From sale of property	Sh 28,900
	<u>Sh 31,000</u>

- ii) The maximum possible loss (sh 28,600) was divided amongst partners in profit sharing ratio;

X	(2/5)	Sh 2,100
Y	(2/5)	Sh 11,440
Z	(2/5)	<u>Sh 5,720</u>
		<u>Sh 28,600</u>

- iii) The debt due from Z (SH 520) was transferred as an uncollectable loss to X and Y on the basis of their capitals:

$$X: \frac{40,700 \times 520}{40,700 + 13,700} = 389$$

$$Y: \frac{13,700 \times 520}{40,700 + 13,700} = 131$$

- 2) In the second table, the opening values are computed by reference to the previous (in this case, first) table.

The opening capital in the first table less any cash distributed as per that table gives the balance of capital with which to commence the second table.

$$\begin{array}{l} \text{For X, } 40,700 - 28,871 = 11,829 \\ \text{Y, } 13,700 - 2,129 = 11,571 \\ \text{Z, } 5,200 - 0 = 5,200 \end{array}$$

- 3) In the last table, the available cash is computed as:

Cash collected from debtors	Sh 4,500
Less: Used for dissolution expenses	<u>Sh 700</u>
	<u>Sh 3,800</u>

- 4) The table will be easier to follow if it can be understood that its sole purpose is to compute amounts distributed to partners, i.e. IT ONLY DEALS WITH CASH FOR PARTNERS.

End of tutorial notes

Property			
	Sh		Sh
Bal b/d	<u>30,000</u>	Realisation	<u>30,000</u>

Equipment			
	Sh		Sh
Bal b/d	<u>15,000</u>	Realisation	<u>15,000</u>

Stock			
	Sh		Sh
Bal b/d	<u>8,000</u>	Realisation	<u>8,000</u>

Debtors			
	Sh		Sh
Bal b/d	<u>4,500</u>	Realisation	<u>4,500</u>

Realisation a/c			
	Sh		Sh
Freehold property	30,000	Cash book	28,900
Equipment	15,000	Cash book	5,300
Stock	8,000	Cash book	2,400
Debtors	4,500	Cash book	4,500
Cashbook: Expenses	700	Capitals: Loss	
		X	6,840
		Y	6,840
		Z	3,240
			<u>17,100</u>
	<u>58,200</u>		<u>58,200</u>

Cashbook			
	Sh		Sh
Bal b/d	2,100	Capitals; X	28,871
Realisation	28,900	Y	2,129
Realisation	5,300	X	2,509
Realisation	2,400	Y	2,251
Realisation	4,500	Z	540
		X	960
		Y	960
		Z	480
		Realisation	700
		Capitals: X	1,520
		Y	1,520
		Z	760
	<u>43,200</u>		<u>43,200</u>

Capitals							
	X	Y	Z		X	Y	Z
Cashbook	28,871	2,129	-	Bal b/d	40,700	13,700	5,200
Cashbook	2,509	2,251	540				
Cashbook	960	960	480				
Cashbook	1,520	1,520	760				
Realisation loss	6,840	6,840	3,420				
	<u>40,700</u>	<u>13,700</u>	<u>5,200</u>		<u>40,700</u>	<u>13,700</u>	<u>5,200</u>

Illustration 9

A, B and C have been partners for several years, sharing profits and losses in the ratio 2:2:1. They decided to dissolve the firm on 31 October 2002, on which date the statement of financial position was as follows:

Statement of financial position as at 31 October 2002

ASSETS	Ksh	Ksh
Non Current Assets		
Property plant and equipment:		
- Land and buildings		150,000
- Plant and machinery		77,200
- Fixtures and fittings		17,000
- Motor vehicles		<u>8,000</u>
		252,200
Goodwill		<u>100,000</u>
		352,000
CURRENT ASSETS		
Stock	64,000	
Debtors	59,000	
Cash	<u>160</u>	
		<u>123,160</u>
		<u>475,360</u>
EQUITY AND LIABILITIES		
Capitals: A		100,000
B		60,000
C		<u>40,000</u>
		200,000
Current accounts A	40,000	
B	<u>30,000</u>	
		<u>70,000</u>
		270,000
NON CURRENT LIABILITIES		
Loan – A		20,000
CURRENT LIABILITIES		
Creditors	57,000	
Bank overdraft	<u>128,360</u>	
		<u>185,360</u>
		<u>475,360</u>

1) The assets were duly sold and monies received as follows:

2002

November 17 th :	Freehold land and buildings	Sh 259,000
December 19 th :	Debtors (Part)	Sh 30,000
	Stock (Part)	Sh 20,000

2003

January 23 rd :	Plant and machinery	Sh 51,000
	Fixtures and fittings	Sh 12,000

	Motor vehicles	Sh 5,000
March 18 th :	Stock (Remainder)	Sh 36,000
	Debtors (Remainder)	Sh 42,000

- 2) Provision was made for dissolution expenses Sh 2,400.
- 3) As soon as sufficient money was available to pay all outstanding creditors, this was done, discounts being received amounting to Sh 1,000.
- 4) Dissolution expenses amounted to Ksh 3,400, and these were paid on 31 March 2003.

Required:

- a) Statements showing how the dissolution proceeds would be distributed to partners; ignoring the ruling in Garner Vs Murray.
- b) The creditors account, realization account, capital accounts and cashbook.

Solution:

A, B and C
Statement of distribution

	Total (Sh)	A (Sh)	B (Sh)	C (Sh)	Distribution (Sh)
Capitals	200,000	100,000	60,000	40,000	
19 th December: Available cash	<u>70,000</u>	<u>40,000</u>	<u>30,000</u>	<u>-</u>	
Maximum possible loss	270,000	140,000	90,000	40,000	
	<u>(52,400)</u>				
	<u>217,600</u>	<u>(87,040)</u>	<u>(87,040)</u>	<u>(43,520)</u>	
		52,960	2,960	(3,520)	
		<u>(1,760)</u>	<u>(1,760)</u>	<u>3,520</u>	
		<u>51,200</u>	<u>1,200</u>	<u>-</u>	<u>52,400</u>

Capitals	217,600	88,800	88,800	40,000	
19 th December: Available cash	<u>50,000</u>				
Maximum possible loss	<u>167,600</u>	<u>(67,040)</u>	<u>(67,040)</u>	<u>(33,520)</u>	
		<u>21,760</u>	<u>21,760</u>	<u>6,480</u>	<u>50,000</u>

Capitals	167,600	67,040	67,040	33,520	
23 rd January: Available cash	<u>(68,000)</u>				
Maximum possible loss	<u>99,600</u>	<u>(39,840)</u>	<u>(39,840)</u>	<u>(19,920)</u>	
		<u>27,200</u>	<u>27,200</u>	<u>13,600</u>	<u>68,000</u>

	Total (Sh)	A (Sh)	B (Sh)	C (Sh)	Distribution (Sh)
Capitals	99,600	39,840	39,840	19,920	
18 th March: Available cash	<u>(77,000)</u>				
Maximum possible loss	<u>22,600</u>	<u>(9,040)</u>	<u>(9,040)</u>	<u>(4,520)</u>	
		<u>30,800</u>	<u>30,800</u>	<u>15,400</u>	<u>77,000</u>

Tutorial notes and workings:

- 1) In the first table, the available cash has been computed as follows:

	Sh
Cash in hand	160
Received on 17 th November	259,000
Set aside for dissolution expenses	(2,400)
Payments to creditors	(56,000)
Repayment of bank overdraft	(128,360)
Repayment of A's loan	<u>(200,000)</u>
	<u>52,240</u>

- 2) Since the ruling in Garner Vs Murray is to be excluded, the amount due from C (at that time assumed to be uncollectable) of Sh 3,520 was divided between A and B based on their profit shares, which are 2/5 and 2/5. Thus the loss was divided equally at Ksh 1,760 per person.
- 3) In the final table, the available cash was computed as follows:

	Sh
Collected from sale of stock	36,000
Collected from debtors	42,000
Less: Additional amounts required for dissolution expenses	<u>(1,000)</u>
	<u>77,000</u>

Creditors A/c			
	Sh		Sh
Cash book	56,000	Bal b/d	57,000
Realisation: Discounts	<u>1,000</u>		
	<u>57,000</u>		<u>57,000</u>
Realisation			
	Sh		Sh
Land and buildings	150,000	Cash book	259,000
Pant and machinery	77,200	Cash book	50,000
Fixtures	17,000	Cash book	68,000
Vehicles	8,000	Cash book	78,000
Stock	64,000	Creditors A/c	1,000
Debtors	59,000	Capitals: Loss	
Cashbook: Expenses	3,400	- A	9,040
Goodwill	100,000	- B	9,040
		- C	4,520
	<u>478,600</u>		<u>22,600</u>
			<u>478,600</u>

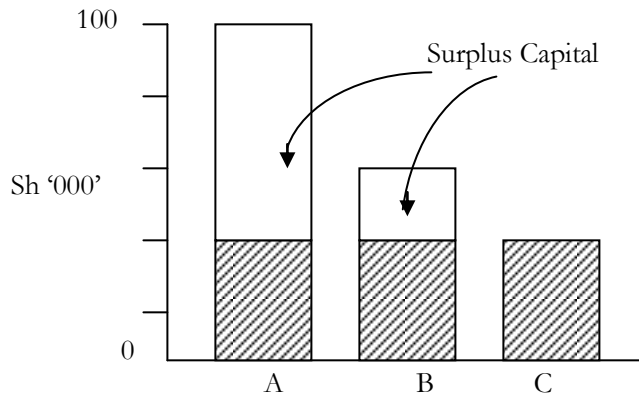
Capitals							
	A (Sh)	B (Sh)	C (Sh)		A (Sh)	B (Sh)	C (Sh)
Cash book	51,200	1,200	-	Bal b/d	100,000	60,000	40,000
Cash book	21,760	21,760	6,480	Current accounts	40,000	30,000	-
Cash book	27,200	27,200	13,600				
Cash book	30,800	30,800	15,400				
Realisation loss	9,040	9,040	4,520				
	<u>140,000</u>	<u>90,000</u>	<u>40,000</u>		<u>140,000</u>	<u>90,000</u>	<u>40,000</u>

Cashbook			
	Sh		Sh
Bal b/d	160	Creditors	56,000
Realisation	259,000	Bank overdraft	128,360
Realisation	50,000	Loan: A	20,000
Realisation	68,000	Capitals: A	51,200
Realisation	78,000	: B	1,200
		Capitals: A	21,760
		: B	21,760
		: C	6,480
		Capitals: A	27,200
		: B	27,200
		: C	13,600
		Capitals: A	30,800
		: B	30,800
		: C	15,400
		Realisation	<u>3,400</u>
	<u>455,160</u>		<u>455,160</u>

THE SURPLUS CAPITAL METHOD:

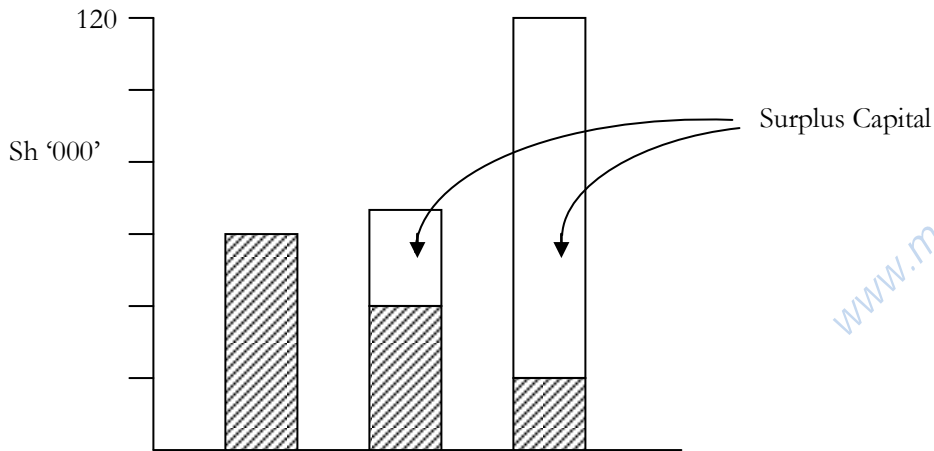
Under this method, the initial amounts repaid to partners are in order to reduce their capitals to amounts such that these are now in the same ratio as that in which they share profits and losses. The amounts so repaid are referred to as “repayment of surplus capital”.

For example, if there are three partners who share profits and losses equally, and have capitals of Ksh 100,000 Ksh 60,000 and Ksh 40,000, the surplus capitals will be as follows:



Once the surplus capital has been paid to partners the remaining capital, known as ‘base capital’ can be repaid. The base capital is in the same ratio as that in which profits and losses are shared. In the illustration, it is 1:1:1(equal). Any cash collected can also be distributed in profit sharing ratio – 1:1:1. This will allow capital balances to fall uniformly as more and more cash is paid to partners.

As a final example to this, assume that there are three partners with capitals of Ksh 60,000, Ksh 75,000 and Ksh 120,000 who share profits and losses in the ratio 3:2:1 respectively. Their surplus capitals can be illustrated as follows:



Of course, there will be a priority payment of surplus capital between the two partners who have surplus capital. The partner who will receive the first payment is said to have been repaid his 'surplus surplus capital'.

The computation of surplus capital (and surplus surplus capital) requires a table that takes the following form:

Statement of surplus capital

	A (Sh)	B (Sh)	C (Sh)	Total (Sh)
Capitals (1)	X	X	X	X
Profit sharing ratio (2)	$\frac{X}{X}$	$\frac{X}{X}$	$\frac{X}{X}$	$\frac{X}{X}$
Capital per unit of profit (1) ÷ (2)	$\frac{X}{X}$	$\frac{X}{X}$	$\frac{X}{X}$	$\frac{X}{X}$
Capital in profit sharing ratio (3)	$\frac{(X)}{X}$	$\frac{(X)}{X}$	$\frac{(X)}{X}$	$\frac{(X)}{X}$
Surplus Capital (1) – (3)	X	=	X	X
Capitals	X	-	X	X
Profit sharing ratio	$\frac{X}{X}$	$\frac{-}{X}$	$\frac{X}{X}$	$\frac{X}{X}$
Capital per unit of profit	$\frac{X}{X}$	$\frac{-}{X}$	$\frac{X}{X}$	$\frac{X}{X}$
Capital in profit sharing ratio	$\frac{(X)}{X}$	$\frac{=}{X}$	$\frac{(X)}{X}$	$\frac{(X)}{X}$
Surplus Capital	=	=	X	X

The table is repeated again and again until only one partner has surplus surplus capital. Every consecutive table eliminates one partner.

Another table known as 'statement of actual distribution' is now necessary to ascertain the amount from each collection to be paid to individual partners. It will take the following form:

Statement of actual distribution

	A (Sh)	B (Sh)	C (Sh)	D (Sh)
1 st Realisation: Part			X (1)	X
Balance	X (2)	—	X (2)	X
	X		X	X
2 nd Realisation: Part	X (3)		X (3)	X
Balance	X (4)	X (4)	X (4)	X
	X	X	X	X
	X	X	X	X
3 rd Realisation	X	X	X	X
	X	X	X	X

- 1) The surplus as per the last section in the statement of surplus capital is the first to be paid off.
- 2) If the cash collected is sufficient to pay off the entire surplus and some excess remains, such excess is used to pay the surplus in the last but one section of the statement of surplus capital.
- 3) Cash collected is used to settle any outstanding balances on the last but one section of the statement of surplus capital.
- 4) From this point on all cash is divided amongst all partners in profit sharing ratio.

Tutorial notes:

- a) The above statement of actual distribution may have variations in formats and positioning of values. It will depend highly on the amount of cash collected and the amount of surplus awaiting repayment.
- b) Provided cash is to be paid to more than 1 partner it must be paid out in PROFIT SHARING RATIO. This is irrespective of whether the repayment is surplus capital or base capital.
- c) Do not worry if the explanations seem confusing. The next two illustrations will help to clarify matters.]

Illustration 10

We will now solve illustration 8 using this method of ascertaining the interim distributions to partners. You are advised to revisit the illustration and familiarize yourself with the facts.

Statement of Surplus Capital

	X(sh)	Y(sh)	Z (sh)	Total (sh)
Capitals	40,700	13,700	5,200	59,600
Profit sharing ratio	2	2	1	5
Capital per unit of profit	20,350	6,850	5,200	N/A
Capital in profit sharing ratio	(10,400)	(10,400)	(5,200)	(26,000)
Surplus Capital	<u>30,300</u>	<u>3,300</u>	-	33,600
Capitals	30,300	3,300	-	33,600
Profit sharing ratio	2	2	-	4
Capital per unit of profit	15,150	1,650	-	N/A
Capital in profit sharing ratio	(3,300)	(3,300)	=	(6,600)
Surplus Capital	<u>27,000</u>	=	-	27,000

Statement of actual distribution

	X (Sh)	Y (Sh)	Z (Sh)	Total (Sh)
1 st Realisation: Part	27,000	-	-	27,000
Balance 2:2	<u>2,000</u>	<u>2,000</u>	-	<u>4,000</u>
	29,000	2,000	-	31,000
2 nd Realisation: Part	1,300	1,300	-	2,600
Balance 2:2:1	1,080	1,080	540	2,700
	2,380	2,380	540	5,300
	31,380	4,380	540	36,300
3 rd Realisation 2:2:1	960	960	480	2,400
4 th Realisation 2:2:1	1,520	1,520	760	3,800
	<u>33,860</u>	<u>6,860</u>	<u>1,780</u>	<u>42,500</u>

Tutorial notes and workings:

a) In the statement of surplus capital, the following steps have been applied:

- The capital per unit of profit is computed by dividing the capitals by profit shares. This is not done for the totals column.
- The lowest capital per unit of profit is selected. In the first table it is Sh 5,200 (for partner Z).
- For each partner this is multiplied by the profit share to get the capitals in profit sharing ratio, e.g.

▪ For X:	5,200 x 2	=	10,400
▪ For Y:	5,200 X 2	=	10,400
▪ For Z:	5,200 X 1	=	5,200

$$\blacksquare \text{ For Total: } 5,200 \times 5 = 26,000.$$

- This can now be deducted from the capitals above the boxes in order to ascertain surplus capitals.
- b) In the statement of actual distribution the following steps have been applied:
- Reference is made to the statement of surplus capital, starting from the BOTTOM, going towards the TOP.
 - For starters, Sh 27,000 should be paid to X. Show this in the columns for X and the Totals.
 - The total cash available at the time was Sh 31,000; this leaves Sh 4,000 to be distributed.
 - Reference is once again made to the statement of surplus capital, but to the table before the last.
 - This shows that CUMULATIVELY, X should receive Sh 30,300 and Y should receive Sh 3,300. Any cash is distributed in profit sharing ratio, so the Sh 4,000 is distributed at Ksh 2,000 each to X and Y. (Their profit sharing ratio is 2:2).
 - From the second realization, (Sh 5,300) X and Y are each given Sh 1,300 so as to complete their surplus capital repayments at:

X:	27,000	Y:	-
:	2,000	:	2,000
:	1,300	:	1,300
	30,300		30,300

- All the balance of cash from the second collection and future realizations are distributed in full profit sharing ration to all partners.

End of tutorial notes and workings

Capitals

	X (Sh)	Y (Sh)	Z (Sh)		X (Sh)	Y (Sh)	Z (Sh)
Cash book	29,000	2,000	-	Bal b/d	40,700	13,700	5,200
Cash book	2,380	2,380	540				
Cash book	960	960	480				
Cash book	1,520	1,20	760				
Realisation loss	6,840	6,840	3,420				
	40,700	13,700	5,200		40,700	13,700	5,200

Illustration 11

We will now solve illustration 9 using the surplus capital method of ascertaining the interim distributions to partners. You are once again advised to revisit the illustration and familiarize yourself with the facts.

Statement of Surplus Capitals

	A (Sh)	B (Sh)	C (Sh)	Total (Sh)
Capitals	140,000	90,000	40,000	270,000
Profit sharing ratio	2	2	1	5
Capital per unit of profit	70,000	45,000	40,000	N/A
Capital in profit sharing ratio	(80,000)	(80,000)	(40,000)	(200,000)
Surplus Capital	<u>60,000</u>	<u>10,000</u>	-	70,000
Capitals	60,000	10,000	-	70,000
Profit sharing ratio	2	2	-	4
Capital per unit of profit	30,000	5,000	-	N/A
Capital in profit sharing ratio	(10,000)	(10,000)	-	(20,000)
Surplus Capital	<u>50,000</u>	=	-	50,000

Statement of actual distribution

	A (Sh)	B (Sh)	C (Sh)	Total (Sh)
17 th November: Part realisation	50,000	-	-	50,000
Realisation Balance	<u>1,200</u>	<u>1,200</u>	-	<u>2,400</u>
	51,200	1,200	-	52,400
19 th December: Part realisation	8,800	8,800	-	17,600
Realisation Balance	<u>12,960</u>	<u>12,960</u>	6,480	<u>32,400</u>
	21,760	21,760	6,480	50,000
	72,960	22,960	6,480	50,000
23 rd January: Realisation proceeds	27,200	27,200	13,600	68,000
18 th March: Realisation proceeds	30,800	30,800	15,400	77,000
	<u>130,960</u>	<u>80,960</u>	<u>35,480</u>	<u>247,400</u>

Capitals

	A (Sh)	B (Sh)	C (Sh)		A (Sh)	B (Sh)	C (Sh)
Cash book	51,200	1,200	-	Bal b/d	100,000	60,000	40,000
Cash book	2,760	21,760	6,480	Current accounts	40,000	30,000	-
Cash book	27,200	27,200	13,600				
Cash book	30,800	30,800	15,400				
Realisation loss	9,040	9,040	4,520				
	<u>140,000</u>	<u>90,000</u>	<u>40,000</u>		<u>140,000</u>	<u>90,000</u>	<u>40,000</u>

Note: The realisation loss has simply been copied in from the realisation account. This has not been drawn up again; it would have been exactly as the one in illustration 9.

Example

The trial balance extracted from the books of Newa, Omae, Pekka and Omar on 30 April 2000 was as follows.

	Sh. '000'	Sh. '000'
Freehold property (Net book value)	6,000	
Plant and Equipment (NBV)	1,395	
Office equipment (NBV)	2,030	
Vehicle (NBV)	1,075	
Stock	3,405	
Debtors	1,590	
Creditors		785
Bank overdraft		210
Capital accounts Newa		6,750
Omae,		4,050
Pekka		2,700
Omar	250	2,700
Current accounts: Newa	1,350	
Omae,	300	
Pekka		
Omar	17,395	17,395

The business has steadily declining in the past few years. The partners have been trying to sell the business as a going concern but have been unable to do so. They decided to sell the assets on a piece meal basis and cash would be distributed to partners as soon as possible in amounts which would ensure that no partner would be called upon to repay any moneys he had received. In the partnership agreement profits and losses were shared between Newa, Omae, Pekka and Omar in the ratio 4:3:2:1 respectively and the application of the rule in Garner Murray was excluded.

Transactions have taken place as follows.

- 15 May 2000 All the motor vehicles were sold at the Car Bazaar for Sh.975,000 net of selling cost. The money was put into the bank account.
- 31 May 2000 Cash collected from debtors Sh.122,000 and stock sold to realize Sh.1,070,000 after cost. All creditors were paid and the cash distribution made.
- 30 June 2000 Cash collected from debtors Sh.248,000 and stock sold to realize Sh.955,000 net. Second cash distribution was made.
- 31 July 2000 Cash collected from debtors Sh.1,100,000 from sale of stock (net) Sh.1,465,000. Third cash distribution was made.
- 31 August 2000 Office equipment sold for Sh.1,950,000 (net) and plant and equipment sold for Sh.1,610,000. Fourth cash distribution was made.
- 31 October 2000 The freehold property was sold for Sh.6,600,000 various distribution expenses of Sh.200,000 were paid the final distribution of cash took place

Required:

- (a) A partnership distribution schedule: (12 marks)
- (b) Summary bank realization and partners' capital accounts. (8 marks)

(Total: 20 marks)

Solution

2. Actual cash distribution schedule

	TOTAL Sh. '000'	N Sh. '000'	O Sh. '000'	P Sh. '000'	Q Sh. '000'
31 May Cash available;					
Motor vehicles	975				
Debtors	122				
Inventory	<u>1,070</u>				
	2,167				
Less: Dissolution expenses	(200)				
Bank overdraft	(210)				
Creditors	<u>(785)</u>				
Cash available for 1 st distribution	972				
1 st distribution (-: -: -: -1)	<u>(972)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>972</u>
1 st payment	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>972</u>
30 th June cash available:- Debtors	248				
Stock	<u>955</u>				
	1,203				
Balance of 1 st distribution (-: -: -: -1)	(303)	-	-	-	303
2 nd distribution (4: 0: 0: 1)	<u>900</u>	<u>720</u>	<u>-</u>	<u>-</u>	<u>180</u>
2 nd cash payment	<u>-</u>	<u>720</u>	<u>-</u>	<u>-</u>	<u>483</u>
31 st July cash available Debtors	1,100				
Stock	<u>1,465</u>				
	2,565				
Balance of 2 nd distribution (4: 0: 0:1)	(1,225)	980			245
3 rd distribution (4: 0: 2:1)	<u>1,340</u>	<u>766</u>	<u>-</u>	<u>383</u>	<u>191</u>
3 rd cash payment	<u>-</u>	<u>1,746</u>	<u>-</u>	<u>383</u>	<u>436</u>
31 st August: Cash available; Equipment	1,950				
Plant	<u>1,610</u>				
	3,560				
Balance of 3 rd distribution (4: 0: 2: 1)	(760)	434	-	217	109
4 th distribution (4:3:2:1)	<u>2,800</u>	<u>1,120</u>	<u>840</u>	<u>560</u>	<u>280</u>
4 th cash payment	<u>-</u>	<u>1,554</u>	<u>840</u>	<u>777</u>	<u>389</u>
31 st October Cash available: Property	6,600				
4 th distribution (4: 3: 2: 1)	<u>6,600</u>	<u>2,640</u>	<u>1,980</u>	<u>1,320</u>	<u>660</u>
Final cash payment (5 th)	-	<u>2,640</u>	<u>1,980</u>	<u>1,320</u>	<u>660</u>
TOTAL CASH PAID		<u>6,660</u>	<u>2,820</u>	<u>2,480</u>	<u>2,940</u>

Maximum possible loss method

	TOTAL	N	O	P	Q
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
Capital account	16,200	6,750	4,050	2,700	2,700
Current account	<u>(1,700)</u>	<u>(250)</u>	<u>(1,350)</u>	<u>(300)</u>	<u>200</u>
TOTAL	14,500	6,500	2,700	2,400	2,900
31 st May: Cash available	<u>(972)</u>				
Max. possible loss (in PSR)	13,528	<u>(5,411.2)</u>	<u>(4,058.4)</u>	<u>(2,705.6)</u>	<u>(1,352.8)</u>
		1,088.8	(1,358.4)	(305.6)	1,547.2
Revaluation of loss (PSR)		<u>(1,331.2)</u>	<u>1,358.4</u>	<u>305.6</u>	<u>(332.8)</u>
		(242.4)	-	-	1,214.4
Reallocation of loss (PSR)		<u>242.4</u>	<u>—</u>	<u>—</u>	<u>(242.4)</u>
1 st cash per payment		-	-	-	972
Bal b/d	13,528	6,500	2,700	2,400	1,928
20 th June: Cash available	<u>(1,203)</u>				
Max. possible loss (PSR)	12,325	<u>(4,930)</u>	<u>(3,697.5)</u>	<u>(2,465)</u>	<u>(1,232.5)</u>
		1,570	997.5)	(65)	695.5
Reallocation of loss (PSR)		<u>(850)</u>	<u>997.5)</u>	<u>65</u>	<u>(212.5)</u>
2 nd cash payment		<u>720</u>	<u>—</u>	<u>—</u>	<u>483</u>
Bal b/d	12,325	5,780	2,70	2,400	1,445
31 July Cash available	<u>(2,565)</u>				
	9,760	<u>(3,904)</u>	<u>(2,928)</u>	<u>(1,952)</u>	<u>(1,976)</u>
		1,876	(228)	448	469
Reallocation of loss		<u>(130)</u>	<u>228</u>	<u>(65)</u>	<u>(33)</u>
3 rd Cash payment		1,746	-	383	436
Balance b/d	9,760	4,034	2,700	2,017	1,009
31 st August: cash available	<u>(3,560)</u>				
	6,200	<u>(2,480)</u>	<u>(1,860)</u>	<u>(1,240)</u>	<u>(620)</u>
4 th cash payment		<u>1,554</u>	<u>840</u>	<u>777</u>	<u>389</u>
Bal b/d	6,200	2,480	1,860	1,240	620
31 st October: Cash available	<u>(6,600)</u>				
Max. possible profit	<u>(400)</u>	<u>160</u>	<u>120</u>	<u>80</u>	<u>40</u>
		<u>2,640</u>	<u>1,980</u>	<u>1,320</u>	<u>660</u>

Realization account

Freehold property	6,000	C B Motor vehicles	975
Plant and equipment	1,395	Equipment	1,950
Office equipment	2,030	Plant	1,610
Vehicles	1,075	Property	6,600
Stocks	3,405	Debtors	7,470
Debtors	1,590	Inventory	3,490
Bank dissolution exp.	200		
Capital account			
Gain on realization dissolution	N	160	
	O	120	
	P	80	
	Q	<u>40</u>	
		<u>16,095</u>	<u>16,095</u>

Bank account

Realization: Motor vehicles	975	Realization dissolution exp.	200
Equipment	1,950	Bank overdraft	210
Plant	1,610	Creditors	785
Property	6,600	Capital accounts N	6,660
Debtors	1,470	O	2,820
Inventory	3,490	P	2,480
		Q	<u>2,940</u>
	<u>16,095</u>		<u>16,095</u>

Capital account

	N	O	P	Q		N	O	P	Q
Current a/c	250	1,350	300	-	Bal b/d	6,750	4,050	2,700	2,700
Cash book	6,660	2,820	2,480	2,940	Realization gain	160	120	80	40
					Current a/c				<u>200</u>
	<u>6,910</u>	<u>4,170</u>	<u>2,780</u>	<u>2,940</u>		<u>6,910</u>	<u>4,170</u>	<u>2,780</u>	<u>2,940</u>

1.5 AMALGAMATIONS

Two sole traders and a partnership, two or more partnerships or a sole trader and other partnerships may combine or join together to form a single partnership.

The benefit of amalgamation includes:

- i) An expansion of the capital base
- ii) Wider pool of experts

In accounting, for amalgamation, the process involves closing off the books of the individual partnerships or businesses and preparing the opening statement of financial position of the newly combined business. The process of closing the books of individual businesses follows the same procedure as that of dissolutions but instead of assets being sold, they are being taken over in the new business.

Therefore a realization account is opened whereby the book values of the assets are debited and newly agreed values are credited. The balance of the realization account represents a profit or loss on amalgamation which is closed off to the capital accounts according to the old profit sharing ratio.

The capital required by each partner in the new business should be balance carried down (c/d) in the partners capital accounts. The balancing figures in the capital accounts will be the cash that will be either paid out or introduced by a partner.

The remaining cash in an individual business will now be transferred to the newly combined business.

Example

On the 1st January 19-8 the partners of Gee and Co and Bee & Co agreed to amalgamate their business. The new firm is to be called Beegee & Co. The initial capital of £18,000 is to be shared as to one half share to the individual partners of Bee & Co.

The division of the one half share to the individual partners is to be in the ratio of their capital in the former partnerships. Any adjustments in the old partnerships are to be made personally between the partners. The statement of financial positions on 31st December 19-7 showed the following.

	Gee & Co		Bee & Co	
	£	£	£	£
Capital Accounts				
Alan	4,000		Desmond	4,000
Brian	3,000		Ernest	2,000
Colin	<u>2,000</u>			<u> </u>
		9,000		6,000
Current Accounts				
Alan	800		Desmond	1,350
Brian	620		Ernest	1,250
Colin	<u>180</u>			<u> </u>
		1,600		2,600
		<u>900</u>		<u>1,100</u>
		<u>11,500</u>		<u>9,700</u>
Non Current assets				
Goodwill	1,500			1,750
Fixtures & Fittings	1,250			<u>1,000</u>
		2,750		2,750
Current Assets				
Receivables	7,000		6,000	
Work in progress	900		750	
Cash	850		<u>200</u>	
		<u>8,750</u>		<u>6,950</u>
		<u>11,5000</u>		<u>9,700</u>

For the purposes of the amalgamation it was agreed as follows:

1. Goodwill in the new firm is to be £4,000.
2. Fixtures and fittings are to be taken over from Gee & Co at a value of £600 from Bee & Co at a value of £500.
3. Receivables are to be taken over at the amounts shown in the old firms' statement of financial positions on 31st December 19-7 less a discount of 5%. Work in progress is to be valued at 10% of the net debtors taken over. Responsibility for the creditors of both firms is to be assumed by the new firm.
4. The balance required for the initial capital is to be provided in cash.
5. All partners in the new firm are to receive a salary at the rate of £4,000 per annum, interest on capital at 8% per annum, and share in the balance of profits/losses in proportion to their capital in the firm. No interest is to be given on current accounts.
6. The only drawings by each partner against his share of the profits were monthly payments of £300 and an additional payment equal to 5% of his capital at the end of each quarter.

On 1st October 19-8 Desmond was killed in a motor accident. A repayment of capital amounting to £1,000 was made immediately to his estate but no further payments were made in 10-8. Interest on the outstanding capital account was agreed at 10% per annum but this should be based on the initial capital less the amount paid. No adjustments were

made to the remaining partners' capital accounts and the profit sharing ratios between the individual partners did not change.

Profits for the year ended 31st December 19-8 amounted to £37,472 before charging interest on amounts due to Desmond.

You will be required to prepare:

- The initial statement of financial position of Beegee & Co immediately after the amalgamation, and
- Partners' current accounts in columnar form for the year ended 31st December 19-8.

Solution

(a)

Even though the question does not require the books of the old firms to be closed this can be done done by preparing the realization account, the capital accounts and the cashbook of the firms before preparing the opening statement of financial position.

Realization a/c					
	Gee & Co £.	Bee & Co £.		Gee & Co £.	Bee & Co £.
Goodwill	1500	1750	To new firm		
Fix. & fittings	1250	1000	Goodwill	2000	2000
Receivables	7000	6000	Fix & Fitti	600	500
Workin progress	900	750	Receivables	6650	5700
			WIP	665	570
			<u>Loss to Cap</u>		
			Alan - 4	327	
			Brian - 3	245	
			Colin - 2	163	
			Desmond - 4		487
			Ernest - 2		243
	<u>10650</u>	<u>9500</u>		<u>10650</u>	<u>9500</u>

Capital Accounts (this will be presented in columnar form)

	Alan £	Brian £	Colin £	Desmond £	Ernest £
Credits					
Balance b/f	4000	3000	2000	4000	2000
Current accounts	800	620	180	1350	1250
Cash brought in by paertner (bal fig)				<u>1137</u>	
Total for credits	4800	3620	2180	6487	3250
Debits					
Loss on Realization	327	245	163	487	243
Cash paid out to the partner (bal fig)	<u>473</u>	<u>375</u>	<u>17</u>		<u>7</u>
Total for debits	<u>800</u>	<u>620</u>	<u>180</u>	<u>487</u>	<u>250</u>
Balance carried down to the new business	<u>4000</u>	<u>3000</u>	<u>2000</u>	<u>6000</u>	<u>3000</u>

		Cashbook			
	Gee & Co	Bee & Co		Gee & Co	Bee & Co
	£.	£.		£.	£.
Balance b/f	850	200	Capital		
Capital- Desmond		1137	Alan	473	
			Brian	375	
			Colin	17	
			Ernest		7
To new firm	<u>15</u>		To new firm		1330
	<u>10650</u>	<u>9500</u>		<u>10650</u>	<u>9500</u>

Beegee & Co.**Statement of financial position as at 1 January 19-8**

Non Current assets	£	£
Fixtures and fittings (600+500)		1,100
Goodwill		<u>4,000</u>
		5,100
Current assets		
Receivables (7000+6000 less provision at 5%)	12350	
Work in progress (at 10% of receivables)	1235	
Cash (1330-15)	<u>1,315</u>	
	14,900	
Current liabilities		
Payables	<u>(2000)</u>	12,900
		<u>18,000</u>
Capital Accounts: Alan		4000
Brian		3000
Colin		2000
Desmond		6000
Ernest		<u>3000</u>
		<u>18,000</u>

(b) To prepare the current account we will need to prepare the appropriation account to account for the distribution of profits before and after Desmond's Death.

The profits will be split based on months such that for the first nine months it is £28,104 (9/12X28,104) and for the last three months £9,368 (3/12X 37472). But please note that Desmond is entitled to interest at 10% during the last three months based on the initial capital less the amount paid. Therefore we will deduct this interest from the profits of the last three months. The amount deducted is (10% X (6000- 1000))X 3/12 = 125. Therefore the profits for the last three months will be £ 9,368 – £128 = £ 9,243.

Profit and loss appropriation account		1 st nine months					
3moths	Total					2 nd	
		£	£	£	£	£	£
Net profit			28,104		9243		37347
Less Interest on Capital							
Alan		240		80		320	
Brian		180		60		240	
Colin		120		40		160	
Desmond		360				360	
Ernest		<u>180</u>	<u>(1080)</u>	<u>60</u>	<u>(240)</u>	<u>240</u>	<u>(1320)</u>
			27024		9003		36,027
Salaries							
Alan		3000		1000		4000	
Brian		3000		1000		4000	
Colin		3000		1000		4000	
Desmond		3000				3000	
Ernest		<u>3000</u>	<u>(15,000)</u>	<u>1000</u>	<u>(4000)</u>	<u>4000</u>	<u>(19000)</u>
			12024		5003		17027
Share of profits							
Alan		2672		1667		4339	
Brian		2004		1251		3255	
Colin		1336		834		2170	
Desmond		4008				4008	
Ernest		<u>2004</u>	<u>(12024)</u>	<u>1251</u>	<u>(5003)</u>	<u>3255</u>	<u>(17027)</u>

Current accounts (this will be presented in columnar form)

	Alan	Brian	Colin	Desmond	Ernest
	£	£	£	£	£
Credits					
Interest on Capital	320	240	160	360	240
Salaries	4000	4000	4000	3000	4000
Profits	<u>4339</u>	<u>3255</u>	<u>2170</u>	<u>4008</u>	<u>3255</u>
Total for credits	<u>8659</u>	<u>7495</u>	<u>6330</u>	<u>7368</u>	<u>7495</u>
Debits					
Drawings: Normal (30 September) (9 X 300)	2700	2700	2700	2700	2700
Extra (5% X Capital X 3 quarters)	600	450	300	900	450
Drawings : normal (31 December) (3 X 300)	900	900	900		900
Extra (5% X Capital X 1 Quarter)	200	150	100		150
To the Executors				3768	
Total for debits	<u>4400</u>	<u>4200</u>	<u>4000</u>		<u>4200</u>
Balance carried down to the statement of financial position (CR)	<u>4259</u>	<u>3295</u>	<u>2330</u>		<u>3295</u>

1.6 CONVERSION INTO A COMPANY

The partners may convert their business and trade in form of a company. This may be due to some of the advantages a company has over a partnership. E.g. Limited liability of members and the number of members of a company can be more than twenty with an exception to professional firms.

The objective of accounting for conversions is to ensure that any profit or loss on conversion is reported and shared between the partners and the opening position of the company is ascertained.

The procedure therefore involves closing off the books of the partnership and preparing the opening statement of financial position of the company. A realization account thus used to facilitate the process and the balance on the realization account is the profit or loss on conversion which is closed off to the partners capital accounts.

The book values of the assets being taken over by the company will be posted to the debit side and the liabilities will be posted to the credit side. The purchase consideration paid by the company to the partners will be posted on the credit side of the realization account. If the expenses of formation are to be borne of the partners or the partnership, then this will be posted to the debit side of the realization account.

NOTE: If the formation costs are to be borne by the company then the profit or loss on realization will be the same as the company then the new company (being the difference between purchase consideration and the net assets acquired)

If the conversion takes place partway during the year, then it is important to update the partners capital and current accounts before closing off the books of the partnership. This means that the income statement for the year should be split between the two periods i.e. when the business was run as a partnership and when the business was run as a company.

The income statement relating to the partnership period will include the profit and loss appropriation account showing how profits have been shared between the partners.

The income statement for the company will also have the profit and loss appropriation but this time it will only be for dividends and retained profits that will be taken to the statement of financial position.

The amounts due to the partners according to the balances in their capital accounts after making adjustments for profit or loss on conversion will be satisfied by payments made from the company in form of shares (ordinary or preference) and loan stock. The shares and loan stock will be shared between partners according to the same agreed ratio and the balance may be by way of paying or being paid cash.

However different approaches may also be used to close off the books of the partnership and preparing the opening statement of financial position of the company.

Example

Kamau Maneno and Rotino have carried on partnership for several years, sharing profits and losses equally after allowing for annual salaries as follows:

	Sh.
Kamau	1,500,000
Maneno	900,000
Rotino	900,000

They decided to convert the partnership into limited company; Kamaro Ltd.as at 30 November 2001, the following terms:

1. Goodwill to be valued at Sh.13,500,000
2. Other assets to be valued as follows:

	Sh.
Freehold property	27,000,000
Furniture and fittings	2,400,000
Motor Vehicles	6,000,000

3. Each partner is becoming director of the company at the same salary as that previously allowed in the partnership.
4. Maneno's loan is to be converted into share capital at par.
5. Shares are to be issued to each partner at par in respect of the amounts of their equity holdings at 30 November 2001.
6. The financial year of partnership ends on 30 May .No action has been taken to carryout the terms of conversion of partnership into the limited company in the books of accounts. On 31 May 2002, the trial balance showed the following position:

	Sh '000'	Sh '000'
Capital accounts at 1 June 2001		
Kamau		18,000
Maneno		9,000
Rotino		6,000
Stock -31 May 2002	14,400	
Cost of sales	36,000	
Sales		60,000
Administrative expenses	6,000	
Selling expenses	3,000	
Accounting & Audit expense	1,200	
Incorporation expenses	600	
Drawings:		
Kamau	1,500	
Maneno	900	
Rotino	900	
Freehold property at cost	25,800	
Furniture and fittings at cost	6,000	
Accumulated depreciation		3,600
Debtors and Creditors	9,000	7,200
Prepayments and Accruals	600	300
Loan from Maneno(10% interest per annum)		9,000
Motor Vehicles at cost	12,000	
Accumulated depreciation		3,600
Bank balance	<u> </u>	<u>1,200</u>

117,900 117,900

Additional information;

- i. The sales during the second half of the year were 60% of the total sales though the gross profit percentage remained the same throughout the year.
- ii. The selling expenses were proportional to the sales for each period. All the expenses were incurred evenly throughout the year.
- iii. Salary drawings were made evenly. Drawing made after incorporation were to be treated as director's salaries.
- iv. There were no purchases or sales of fixed assets during the year. Depreciation is to be provided on cost as follows;

Furniture and fittings	10% per annum
Motor vehicles	20% per annum
- v. No dividends are paid or proposed but it is decided to write off the incorporation expenses and also Sh.3,500,000 of the goodwill.

Required

- (a) Income statement for Kamaro Ltd. for the six months ended 31 May 2002 (8 marks)
- (b) Calculation showing the value of shares to be issued to each partner. (4 marks)
- (c) Statement of financial position as at 31 May 2002. (8 marks)

Solution

KAMARO LTD.
Trading, Profit and Loss account

For the year ended 31 May 2002

	1 st month		2 nd month	
	Sh. '000'	Sh. '000	Sh. '000'	Sh. '000'
Sales		24,000		36,000
Cost of sales		<u>(14,400)</u>		<u>(21,600)</u>
Gross profit		9,600		14,400
Expenses				
Depreciation on furniture	300		120	
Depreciation on motor vehicles	1,200		600	
Administrative expenses	3,000		3,000	
Selling expenses	1,200		1,800	
Audit expenses	600		600	
Incorporation expenses	-		600	
Directors salaries – Kamau	-		750	
Maneno	-		450	
Rotino	-		450	
Loan interest	450		-	
Goodwill written off		<u>(6,750)</u>	<u>3,500</u>	<u>(11,870)</u>
Profit to be shared in PSR		2,850		<u>2,530</u>
Less: Salaries: Kamau	750			
Maneno	450			
Rotino	<u>450</u>	<u>(1,650)</u>		
Profit share:		1,200		
Kamau	400			
Maneno	400			

Rotino	<u>400</u>	<u>(1,200)</u>
		<u>-</u>

Capital account

	Kamau	Maneno	Rotino		Kamau	Maneno	Rotino
Balance c/d ordinary share	23,000	23,450	11,000	Bal b/d	18,000	9,000	6,000
				Goodwill	4,500	4,500	4,500
				Ordinary share capital		9,000	
				Current a/c	400	850	400
				Revaluation gain	<u>100</u>	<u>100</u>	<u>100</u>
	<u>23,000</u>	<u>23,450</u>	<u>11,000</u>		<u>23,000</u>	<u>23,450</u>	<u>11,000</u>

Current account

	Kamau	Maneno	Rotino		Kamau	Maneno	Rotino
Drawings	750	450	450	Salaries	750	450	450
Capital a/c	400	850	400	Profit share	40	400	400
				Interest on capital		<u>450</u>	
	<u>1,150</u>	<u>1,350</u>	<u>850</u>		<u>1,150</u>	<u>1,300</u>	<u>850</u>

Revaluation account

Motor vehicle	1,200	Property	1,200
Capital gain		Furniture	300
K	100		
M	100		
R	<u>100</u>		
	<u>1,500</u>		<u>1,500</u>

KAMARU
Statement of financial position as at 31 May 2002

NON- CURRENT ASSETS	Sh. '000	Sh. '000	Sh. '000
	COST	DEPRECIATION	NET BOOK VALUE
Freehold property	27,000	-	27,000
Furniture and fittings	2,400	(120)	2,280
Motor vehicles	<u>6,000</u>	<u>(600)</u>	<u>5,400</u>
			34,680
Goodwill			<u>10,000</u>
			44,680
 CURRENT ASSETS			
Inventory		14,400	
Receivables		9,000	
Prepayments		<u>600</u>	<u>24,000</u>
			<u>68,680</u>
Ordinary share capital			57,450
Retained earnings			<u>2,530</u>
			59,980
 CURRENT LIABILITIES			
Bank overdraft		1,200	
Payables		7,200	
Accruals		<u>300</u>	<u>8,700</u>
			<u>68,680</u>

REINFORCEMENT QUESTIONS

QUESTION ONE

Abincha, Bichage and Chomba are in a partnership and make up their accounts to 31 October each year. Their partnership agreement states that interest should be allowed at 15% per annum on their opening balance of their capital accounts each year, but no interest should be charged on drawings. Abincha, Bichage and Chomba are credited with salaries of Sh.600,000, Sh.600,000 and Sh.800,000 respectively per annum. The remaining profit up to the amount of Sh.800,000 is to be shared in the proportion of their capital balances as at the commencement of the year, and any further profit is to be shared two-fifths to Abincha, two-fifths to Bichage and one-fifth to Chomba. The partnership does not maintain current accounts and drawing accounts are transferred to capital accounts at the end of each year.

The balances on the capital accounts of Abincha, Bichage and Chomba were Sh.1,500,000, Sh.1,200,000 and Sh.1,300,000 respectively on 1 November 1996. In the year ended 31 October 1997, the partnership profit was Sh.4,025,000, drawings by Abincha, Bichage and Chomba were Sh.1,075,000, Sh.870,000 and Sh.1,080,000.

In the year ended 31 October 1998, the partnership profit was Sh.3,950,000; drawings by Abincha, Bichage and Chomba were Sh.1,222,000, Sh.856,000 and Sh.976,000 respectively.

Abincha decided to retire from the partnership on 31 October 1998, the fair value of the identifiable net assets at this date were agreed to equal the book values. Goodwill was valued at Sh.3,000,000. Bichage and Chomba each introduced Sh.1,800,000 into the business on that day and Abincha was paid the balance on his capital account. Bichage and Chomba agreed to remain the partnership under the terms of the original agreement as between themselves. Goodwill is not to be carried in the books of the new partnership and is to be eliminated on 31 October 1998. In all years since the signing of the original partnership agreement, the profits of the partnership after interest on capitals and partners' salaries have exceeded Sh.800,000.

In the year ended 31 October 1999, the partnership profit was Sh.3,340,000; drawings by Bichage and Chomba were Sh.945,000 and Sh.795,000.

On 1 November 1999, Bichage and Chomba decided to dissolve their partnership and sell the assets on a piece meal basis: all their creditors had been paid by 31 October 1999. Any profit or loss on disposal was to be shared in the same ratio they shared any excess over Sh.800,000 after interest and salaries.

On 15 November 1999, they had collected Sh.3,200,000. They shared this between themselves on that day in amounts such that they would not have to make any adjustments later. By 30 November 1999, they had sold all the other assets for Sh.4,500,000 and they made a final distribution among themselves.

Required:

Write up the partners' capital accounts from 1 November 1999

(20 marks)

QUESTION TWO

Kioko, Licha and Mengo had started a partnership on 1 April 1992 when they contributed capital of Sh.9 million, Sh.3 million from Kioko, Sh.2 million from Licha and Sh.4 million from Mengo. No salaries were to be paid to any of the partners, but interest would be credited at 20% per annum – computed on these amounts – and any remaining profit was to be shared equally amongst the partners.

As at 31 March 2002, the statement of financial position of the partnership was as follows (shown horizontally for conciseness):

Assets:				Capital and Liabilities	Kioko	Lich	Mengo	Total
Property, plant and equipment				Capital	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'
	Cost	Depreciation	NBV	Fixed Capital				
	Sh.'000'	Sh.'000'	Sh.'000'	Accounts				
Freehold land	2,000	Nil	2,000	Current Accounts	<u>3,000</u>	<u>2,000</u>	<u>4,000</u>	9,000
Buildings	3,000	900	2,100		<u>3,190</u>	<u>2,000</u>	<u>1,500</u>	<u>6,600</u>
Plant and machinery	12,000	3,000	9,000	Current Liabilities				
Motor vehicles	<u>4,000</u>	<u>3,000</u>	<u>1,000</u>	Trade payables				7,360
	<u>21,000</u>	<u>6,900</u>	<u>14,100</u>					
Current assets:								
Inventory		4,400						
Trade receivables		3,400						
Cash at bank		<u>1,150</u>	<u>8,950</u>					
			<u>23,050</u>					<u>23,050</u>

The business was run by the partners to 31 March 2003. They decided to convert the partnership into a limited company with effect from 1 April 2003. This was to be achieved as follows:

- Property, plant and equipment had been depreciated on opening cost (no assets had been bought or sold in the year to 31 March 2003) by 3% on buildings, 12½% on plant and machinery and 12½% on motor vehicles. The company would take over the land, buildings, plant and machinery at Sh.5 million, Sh.4 million and Sh.10 million respectively. The partnership owned three motor cars which had all be bought at the same time: the one Kioko uses cost Sh.1.6 million; the one Licha uses cost Sh.1.4 million; the one Mengo uses cost Sh.1 million; all the cars have a useful life of eight years and a residual value of nil. Each partner was to take over the motor car he uses – Kioko's for Sh.400,000, Licha's for Sh.260,000 and Mengo's at Sh.205,000.
- Inventory valued at cost for Sh.5.2 million was to be transferred to the company for Sh.5.7 million. One trade receivable for Sh.1.2 million was to be collected personally by Kioko; the partners estimated that only Sh.840,000 would be collected from this debtor. Sh.2.9 million, the balance of trade receivables, would be transferred to the company at book value. Trade payables in the partnership at 31 March 2003 stood at Sh.5.1 million. If payment could be made by 30 April 2003, this liability could be settled for Sh.4.5 million. It was agreed by the three partners that they would introduce Sh.3.22 million immediately to raise the cash in the business to an amount just sufficient to clear this liability immediately so that trade payables could be transferred at Sh.4.5 million. The actual payment to creditors was made by the company a few days later. Kioko paid Sh.1,225,000 into the partnership bank account; Licha paid in Sh.355,000 and Mengo paid in Sh.1,640,000.
- The new company, Kiligo Limited, had an authorized share capital of 2 million shares of Sh.10 each. These shares would be issued to the partners at a premium of 50% in satisfaction of the purchase consideration.
- Kioko had made drawings of Sh.1,440,000 in the year, Licha Sh.960,000; Mengo Sh.1,200,000.

Required:

- (a) Prepare the realization account of the partnership as at 31 March 2003 (8 marks)

- (b) Prepare the partners' capital accounts for the year ended 31 March 2003 (current accounts should be closed off to the capital accounts as early as possible) (8 marks)
- (c) Prepare the opening Statement of financial position of Kiligo Limited. (4 marks)
- (Total: 20 marks)**

QUESTION THREE

Emojong, Barmoi and Kimani have been partners sharing profits and losses in the ratios 2:2:1. Accounts have been prepared on an annual basis to 31 December of each year. Emojong the only active partner, died on 31 May 2002 and the remaining partners decided to cease business from that date. The assets are to be realized, outstanding debts paid and the remainder to be shared by the partners (including the executors of Emojong's estate) in an equitable manner, distributions of cash being made as soon as possible.

Statement of financial position prepared as at 31 May 2002 revealed the following position:

Emojong, Barmoi and Kimani			
Statement of financial position as at 31 May 2002			
	Cost	Accumulated	Net Book
	Sh.'000'	Depreciation	Value
		Sh.'000'	Sh.'000'
Non Current assets			
Goodwill		-	12,500
Freehold land and buildings	12,500	-	18,750
Plant and machinery	18,750	6,975	9,650
Fixtures and fittings	16,625	1,625	2,125
Motor vehicles	3,750	<u>3,000</u>	<u>1,000</u>
	<u>4,000</u>	<u>11,600</u>	<u>44,025</u>
Current assets:			
	<u>55,625</u>		
Stock		8,000	
Debtors			
Less: provision for doubtful debts	8,125	7,375	
Cash	<u>750</u>	<u>20</u>	
		15,395	
Current liabilities:			
Creditors			
Bank overdraft		<u>23,170</u>	(7,775)
	7,125		<u>36,250</u>
Financed by:			
Capital income:			
Emojong			12,500
Barmoi			7,500
Kimani			<u>5,000</u>
			25,000
Current accounts:			
Emojong		5,000	
Barmoi		<u>3,750</u>	<u>8,750</u>
			33,750
			<u>2,500</u>

Long term liabilities: 36,250

Loan – Emojong

Additional information:

1. 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 expense and the cash payable on death of any partner is Sh.5,000,000.

2. The assets were duly sold and the monies received as follows:

		Sh. '000'
14 June 2002	Life policy on Emojong's life	5,000
	Life policy on the lives of Barmoi and Kimani surrendered	2,500
16 July 2002	Freehold land and buildings	25,000
	Debtors (part)	3,750
	Stock (part)	2,500
20 August 2002	Plant and machinery	6,375
	Fixtures and fittings	1,500
	Motor vehicles	625
15 October 2002	Stock (Remainders)	4,500
	Debtors (Remainders)	5,250

3. Provision was to be made for dissolution expenses of Sh.300,000.
4. As soon as sufficient money was available to pay all outstanding creditors, this was done, discounts being received amounting to Sh.125,000.
5. Dissolution expenses amounted to Sh.250,000 and this was paid on 31 October 2002.

Required:

- (a) Statement showing how the proceeds of the dissolution would be shared between the partners (12 marks)
- (b) Realisation account (5 marks)
- (c) Capital accounts 3 marks)

(Total: 20 marks)

QUESTION FOUR

Three firms of accounts decided to amalgamate into a new firm Cheloti Gusera Kandie & Co. with effect from 1 April 1999. Until 31 March 1999 Apopo. Cheloti and Chuma were partners in Apopo Cheloti & Co. sharing capital and profits equally. Guserwa. Kurgat and Ochieng were partners in Guserwa & Co. sharing capital and profits in the ratio 4:4:1. Kandie was a sole practitioner.

The statement of financial positions of the firms as at 31 March 1999 were as follows:

	Apopo Cheloti & Co.		Guserwa & Co.		Kandie
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
Fixed assets: Office equipment		450		420	150
Intangible assets: Goodwill		<u>1,500</u>		<u>1,065</u>	<u>240</u>
		<u>1,950</u>		<u>1,435</u>	<u>390</u>
Current assets: Work-in- progress		1,800		1,050	240
Debtors		5,250		2,625	225
Cash		<u>750</u>		<u>300</u>	<u>165</u>
		<u>7,800</u>		<u>3,975</u>	<u>630</u>
		9,750		5,460	1,020
Capital accounts					
Current accounts: Apopo	270	8,550		4,050	900
Cheloti	360				
Chuma	<u>120</u>		Guserwa	600	
Creditors		750	Kurgat	390	1,050
		<u>450</u>	Ochieng	<u>60</u>	<u>360</u>
		<u>9,750</u>		<u>5,460</u>	<u>1,020</u>

The terms of amalgamation were as follows:

1. Apopo retired on 31 March 1999.
2. The capital of the new firm Cheloti Guserwa Kandie & Co. was to be Sh.15 million and profit sharing ratios and capital contributions were to be Cheloti 30%, Chuma 30%, Guserwa 15%, Kurgat 15%, Ochieng 5% and Kandie 5%.
3. In the opening statement of financial position of the new firm, office equipment was to be bought at the old book values except for that from Apopo Cheloti and Co. where the value was agreed at Sh.300,000. Work-in-progress was agreed at book value and goodwill for three firms at Sh.3 million. Debtors were taken in at book values less 20% discount. Creditors were paid by the old practices. Apopo and Kandie took any cash remaining in their old practices and Guserwa contributed the necessary cash in his old practice. The total goodwill acquired from old partnerships was in the ratio in which they share profits in the new.
4. Partners introduced their balances of capital in cash
5. A salary of Sh.600,000 per annum per partner was given the new partnership. Drawings of Sh.45,000 per month per partner were allowed: at the end of each half year, partners were allowed to draw Sh.30,000 for each 2½ % share of the partnership profit attributable to that partner.
6. On 1 October 1999, it was agreed to take Maina into the partnership on similar terms as to salary and drawings, with a 2½ % share. The capital and profit sharing ratios were altered to Cheloti 22½ %, Chuma 22½ %, Guserwa 20%, Kurgat 20%, Ochieng 5% and Kandie 7 ½%. Kandie and Maina could only bring in two thirds of what was required. It was agreed that the remaining one third should remain in a debit in their current accounts to be cleared against future profits. Cheloti and Chuma withdrew equally the cash capital introduced on 1 October 1999 by Guserwa, Kurgat, Kandie and Maina.
7. The profit of the partnership for the year ended 31 March 2000, after deducting partners' salaries was Sh.4,800,000: this profit was deemed to have accrued evenly over the year as opposed to total profit. The partners made all allowable drawings in full.

Required:

- (a) The opening journal entries of Cheloti Guserwa Kandie and Co. (7 marks)
- (b) The capital and current accounts of each partner (in columnar form)
 - i. In the old practices, so as to indicate the resultant indebtedness between the partners: (8 marks)
 - ii. In the new practice, so as to indicate the balances on 1 April 1999 and 31 March 2000, (10 marks)

(Total: 25 marks)

LESSON TWO

PREPARATION OF PUBLISHED FINANCIAL STATEMENTS

CONTENTS

- International Financial Reporting standards relevant to preparation and presentation of financial statements of limited companies
- Formats of financial statements

OBJECTIVES

- Know the preparation of financial statements in accordance with the provisions of the Companies Act, and Legislation relating to other accounting entities
- Source, authority and use of accounting standards

PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS OF LIMITED COMPANIES

This is a chapter dealing with company financial statements, a topic frequently examined. Do not be put off by the large volume of detail in the chapter. You will gradually acquire the required knowledge through persistent repetitions of the build up illustrations provided throughout the chapter and frequent attempts at the practice questions provided at the end of the chapter.

The preparation of published financial statements involves preparing and presenting financial statements to external users especially shareholders in a form prescribed by the law (Companies Act) and the International Reporting Standards (IFRSs).

The **Companies Act** gives the guidelines on preparation of the financial statements, then registration with the registrar of companies, auditing and certain disclosures such as directors salaries.

The requirements of the **Companies Act as pertaining to accounts can be found in**

SI47:	Keeping proper books of account;
SI48:	Laying final accounts before the members at the AGM;
SI49:	Compliance with financial statements presenting a true and fair view:
S150 – SI54:	Presentation of group accounts to members at the AGM and related matters
S155:	Signing the statement of financial position
S156 – 157:	Constitution of documents to be presented at AGM.
S158:	Sending statement of financial positions and annexed documents to members and debenture holders
	before the AGM
S197:	Directors emoluments disclosure requirements
S198:	Disclosure requirements for loans to directors

Sixth schedule to the Companies Act: Accounts

IFRSs Gives the guideline on the content and the accounting statements of certain events and transactions in the financial statements. The following IFRSs are relevant for the purpose of preparing published financial statements;

IAS 1: - Presentation of Financial Statements

IAS 7: - Cashflow statements

IAS 8: - Accounting policies, changes in accounting estimates and errors

IAS 10: - Events after the statement of financial position date (not examined)

IAS 12: - Income Tax

IFRS 5 - Non-current assets held for sale and discontinued operations. (Not examined)

IAS 1: Presentations of Financial Statements

The objective is to give guidance regarding the preparation of published financial statements and prescribe the content of the published financial statement.

The following information should be prominently displayed and repeated when it is necessary for a proper understanding of the information presented:

- The name of the reporting enterprise and other means of identification.
- Whether the financial statements cover an individual enterprise or a group of enterprises.

- (c) The statement of financial position date or the period covered by the financial statements whichever is appropriate to that component of the financial statements.
- (d) The reporting currency.
- (e) The level of precision used in the presentation of figures in the financial statements (e.g. Shs. '000' or millions of Shs.)

IAS 1 requires companies to observe the following rules in preparing published financial statements:

1. The financial statements should reflect a true and fair view of the company's financial position and performance. Where transactions are reported faithfully and the financial statements comply in all aspects with IFRSs then the true and fair view objective is achieved.
2. The company should apply its accounting policies consistently from one financial period to the next and in case there is a change in the accounting policy then, adequate disclosure should be made.
3. The Financial statement should be prepared on a going concern basis in case the going concern basis isn't suitable; adequate disclosure should be made.
4. The financial statements should be made on an annual basis (should related to a period of 12 months) and in case the period covered is more or less than 12 months then, this fact should be disclosed.
5. The financial statement should be presented on a comparable basis i.e. the current years' and previous years' financial results unless it is the first year of trading.
6. [financial statements should disclose the date when they were approved for issue by the directors.

IAS 1 prescribes the contents of published financial statements. The major reports that are included as part of the published financial statements is:-

- i) The income statement.
- ii) The statement of financial position.
- iii) The statement of changes in equity.
- iv) The Cashflow statement.
- v) The notes to the accounts/financial statements.

The most cases, companies that prepare published financial statements include the following additional reports (that are not financial statements).

- i) Corporate information (Company's address, lawyers. Location, bankers and others).
- ii) Chairman's report (principle business activities of the firm, directors to be elected or retiring, summary results for the year and dividends).
- iii) Auditors report.
- iv) Corporate governance (I.T systems, internal audit, audit committees and other systems in place to ensure good management).
- v) Statistical information (major highlights of the company's performance, over a period of time e.g. 5 years).

THE INCOME STATEMENT

It shows the financial performance of the company during the given financial period. It discloses the income and expenses and thus the net profit for the period.

IAS 1 recommends that the income statement can be presented in 2 ways or formats

- a) **By classifying by function**

Under this format, the expenses of the company are classified into 5 major categories i.e.

- i) Cost of sales [(opening stock + purchases – closing stock) and depreciation]
- ii) Distribution costs (transport costs, selling expenses, commission, provision for bad debts etc)
- iii) Administration expenses (salaries and wages, telephone, rates, postage, rent etc, goodwill amortization)
- iv) Other expenses (all other not falling under the above) groups of expenses)
- v) Finance cost (interest on loan and bank overdraft, interest on finance lease, dividends on redeemable preference shares)

b) Classifying expenses by nature

Under this format, expenses are not classified by their nature i.e. referred to specifically according to their type and the major categories of expenses are:-

- i) Changes in finished goods and work in progress
- ii) Raw materials consumed
- iii) Depreciation and amortization
- iv) Employee benefits (staff costs)
- v) Other expenses
- vi) Finance costs

NOTE: Classification of expenses by function is the most common format used and classification of expenses by nature is more appropriate for manufacturing firms.

There are certain types of incomes and expenses that do not face within the trading activities of the business but are within the ordinary activities of the firm. E.g. disposal of property, plant and equipment and other non-current assets.

The standard requires that if the above incomes and expenses are material, they can either be classified as part of the other expenses or shown separately on the face of the income statement.

The company should give additional information about such items in the notes to the accounts.

Examples:

- a) Profit/Loss on disposal of non-current assets
- b) Material write down or reversal of write down on assets e.g. PPE inventory and debtors.
- c) Restructuring and re-organization cost e.g. redundancy payments
- d) Litigation costs – payments made as a result of court decisions

The format of the income statement is given as follows:

a) By function

ABC LTD		
INCOME STATEMENT FOR THE YEAR ENDED 31/12/		
	£	£
Revenue		x
Cost of sales		<u>(x)</u>
Gross profit		x
Other incomes (e.g. investment income)		<u>x</u>
		x
Expenses		
Distribution costs	x	
Administration costs	x	
Other expenses	x	
Finance costs	<u>x</u>	<u>(x)</u>
Profit before		x
Income tax expense		<u>(x)</u>
Profit for the period		<u><u>xx</u></u>

b) By Nature

ABC LTD		
INCOME STATEMENT FOR THE YEAR ENDED 31/12/		
	£	£
Revenue		x
Other incomes		<u>x</u>
		x
Expenses		
Raw materials consumed	x	
Changes in finished goods and work in progress	x	
Depreciation and amortisation	x	
Employee benefits	x	
Other expenses	x	
Finance costs	<u>x</u>	<u>(x)</u>
Profit before tax		x
Income tax expenses		<u>(x)</u>
Profit for the period		<u><u>xx</u></u>

THE STATEMENT OF FINANCIAL POSITION

It shows the financial position of the company as at the end of a given financial period. The standard requires that assets and liabilities should be classified between current and non-current portions.

Currently, the standard requires the first part of the statement of financial position to show the total assets (i.e. non-current assets + current assets) and the second part of the statement of financial position to show equity and liabilities. Equity is the shareholders funds while liabilities are the total of non-current and current liabilities.

The format of the statement of financial position is given as follows:

ABC LTD		
STATEMENT OF FINANCIAL POSITION AS AT 31/12/		
	£	₹
NON-CURRENT ASSETS		
Property, plant and equipment		x
Goodwill		x
Other intangible assets		x
Investment Longterm		<u>x</u>
		x
CURRENT ASSETS		
Inventory	x	
Accounts receivables and prepayments	x	
Short-term investment	x	
Cash at bank and in hand	<u>x</u>	<u>x</u>
TOTAL ASSETS		<u>xx</u>
EQUITY AND LIABILITIES		
Preference share capital		x
Ordinary share capital		<u>x</u>
		x
RESERVES		
Share premium	x	
Revaluation reserve	x	
General reserve	<u>x</u>	x
Retained profits		<u>x</u>
Shareholders funds		x
NON-CURRENT LIABILITIES		
Loan stock/debentures	x	
Redeemable preference shares	x	
Deferred tax	x	
Other long-term provisions	<u>x</u>	x
CURRENT LIABILITIES		
Bank overdraft	x	
Trade and other payables (accruals)	x	
Current tax (tax payable)	x	
Current portion of loan stock	x	
Prepared dividends (and shares or preference shares)	<u>x</u>	<u>x</u>
TOTAL EQUITY AND LIABILITY		<u>xx</u>

NOTE:

Most of the statement of financial position items are shown in totals and the breakdown of the figures is given by way of notes to the accounts. E.g. property, plant and equipment which is made up of land, buildings, plant and machinery and motor vehicles is given in the statement of financial positions at the total net book values of all these assets and part of the notes to the accounts will explain the make-up of the assets and movements during the year.

No workings should be given/shown in the statement of financial position for most of the items and only the total or the net figures should be presented e.g. accounts receivables should be net of provision for doubtful debts.

IAS 32 requires that redeemable preference shares should be treated as a non-current liability just like any other loan. Therefore, the preference dividends are shown as part of finance costs in the income statement, and other accrued interest and shown as part of current liabilities.

If the company proposes dividends on ordinary and preference share capital before the year end then, this will be provided for in the statements of changes in equity and shown as part of current liabilities in the statement of financial position. However, even the proposed dividends are disclosed after the financial year end, then they will be mentioned only by the way of notes to the accounts and not provided for in the financial statement.

THE STATEMENT OF CHANGES IN EQUITY

This is a very important report because it explains the movements in the shareholder funds during the year and also acts as a link between the income statement and the statement of financial position.

The report also shows the total gains or losses made by the company during the year. Some of these gains or losses may not be included in the income statement e.g. gains or losses on revaluation or PPE and investments (long-term)

The format of the statement of changes in equity is given as follows:

	Preferen ce share capital	Ordinar y share capital	Share premiu m	Revaluati on reserve	Gener al reserv e	Retaine d profits	TOTA L
	£	£	£	£	£	£	£
i) Balance at 1.1	x	x	x	x	x	x	x
ii) Changes in a/c policy/correction of error	-	-	-	-	-	(x)	(x)
iii) Balance as restated (i +ii)	x	x	x	x	x	x	x
iv) Gain/losses on revaluation PPE	-	-	-	x	-	-	x
v) Transfer to retained profits on sale of PPE	-	-	-	(x)	-	x	-
vi) Gain losses on investment revaluation	-	-	-	x	-	-	x
vii) Foreign currency exchange gain/losses	-	-	-	x	-	-	x
viii) Net gains/losses directly reported in equity (iv + v +vi + vii)	-	-	-	x	-	x	x
ix) Profit for the period	-	-	-	-	-	x	x
x) Total gains/losses recognized during the year (viii + ix)	-	-	-	x	-	x	x
xi) Issue of shares	x	x	x	-	-	-	x
xii) Transfer to general reserve	-	-	-	-	x	(x)	-
xiii) Dividends: interim paid	-	-	-	-	-	(x)	(x)
xiv) Final proposed (If prop before year end)	-	-	-	-	-	(x)	(x)
xv) Balance as at 31.12 (x + xi + xii + xiii)	x	x	x	x	x	x	x

The final value of the total should be the same as the shareholder funds in the statement of financial position.

D. THE NOTES TO THE ACCOUNTS

The notes to the accounts provide additional information on the a/c policies that the company has adopted the make-up of some of the items appearing on the face of the financial accounts and additional information on items not provided for in the accounts.

IAS 1 does not give the standard format of the notes to the accounts and that this would vary from one company to another. However, the standard requires the following approach to be used when presenting the notes to the accounts.

1. The company should state the basis of financial statement (most cases historical basis of accounting)
2. The company should present the significant policies adopted
3. The make-up of some of the items appearing on the face of the final accounts e.g. PPE and inventory.
4. Explanation of items not provided for in the final accounts (e.g. Dividends)

An example of the notes to the accounts examined within the scope.

NOTE 1: Accounting Policies.

These financial statements have been prepared under the historical cost basis of accounting which is modified to accommodate the revaluation of certain property, plant and equipment.

Property, plant and equipment are stated in the accounts of cost or revalued amount less accumulated depreciation. Depreciation is based on the estimated useful life of the asset and is provided at the following rates:

<u>Assets</u>	<u>Rate</u>
Land	No depreciation
Buildings	2 % on cost
Plant and machinery	20% on cost
Fixtures, furniture and fittings	25% on cost
Motors vehicles	30% on reducing balance

Inventory is stated at the lower of cost and net realizable value. Cost represents the purchase price or production cost and other expenses incurred to get the inventory ready for sale. Net realizable value is the selling price of the inventory less other expenses that will be incurred to get he inventory ready for sale.

NOTE 2: Profit for the period

The profit for the period has been arrived at after charging the following expenses:

	£	£
Depreciation		x
Amortization (impairment of good will)		x
Directors emoluments:		
Salaries	x	
Fees	x	
Re-imbursment of expenses	x	
Pension	x	
Compensation for loss of office	x	x
Other employee benefits		
Salaries and wages	x	
Pension costs	x	
NHIF	x	x
Auditors remuneration		x
Loss on disposal of PPE		x
Restructuring /Re-organization costs		x

NOTE 3: Property, plant and equipment

	Land	Building	Plant & Machinery	Fixture, furniture & fittings	Motor vehicle	TOTAL
	£	£	£	£	£	£
Balance as at 1.1	x	x	x	x	x	x
Additions (purchase)	x	x	x	x	x	x
Revaluation gain	x	x	-	-	-	-
Disposal	(x)	(x)	(x)	(x)	(x)	(x)
Balance as at 31.12	x	x	x	x	x	x
Depreciation						
Balance as at 1.1	-	x	x	x	x	x
Change in the year	-	x	x	x	x	x
Eliminated in disposal	-	(x)	(x)	(x)	(x)	(x)
Eliminated in revaluation	-	(x)	(x)	(x)	(x)	(x)
	-	x	x	x	x	x
Net book value						
As at 31.12	x	x	x	x	x	x
As at 1.1	x	x	x	x	x	x

NOTE 4: Inventory

Inventory is made up as follows:

	£
Raw materials	x
Work in progress	x
Finished goods	x
	<u> </u>
	<u> </u> <u> </u>
	xx

NOTE 5: Dividends

During the year, the company paid a dividend of Sh.2 per share on the ordinary shares outstanding and Sh.1 on the preference shares outstanding. The company is now proposing a final dividend of Sh.3 per share on ordinary shares and sh.1 on preference shares.

NOTE 6: Capital Commitments

The company has contracted X constructors to construct a warehouse a total cost of £200,000. Construction is to begin on 1st June.

Example 1

The accountant of Wislon Co has prepared the following list of account balances as at 31 December 2005

	£ ' 000'
50p ordinary shares (fully paid)	350
7% £1 preference shares (fully paid)	100
10% Loan stock	200
Retained earnings 1.1.2005	242
General reserve 1.1.2005	171
Land and buildings 1.1.2005(cost)	430
Plant and machinery 1.1.2005 (cost)	830
Aggregate depreciation	
Buildings 1.1.2005	20
Plant and machinery 1.1.2005	222
Inventory 1.1.2005	190
Sales	2,695
Purchases	2,152
Preference dividend	7
Ordinary dividend (interim)	8
Interest on Loan stock	10
Wages and salaries	254
Light and heat	31
Sundry expenses	113
Suspense account	135
Trade accounts receivable	179
Trade accounts payable	195
Cash	126

Additional information

- a) Sundry expenses include £9,000 paid in respect of insurance for the year ending 1 September 2005. Light and heat does not include an invoice of £3,000 for electricity for the three months ending 2 January 2006, which was paid in February 2006. Light and heat also includes £20,000 relating to salesmen's commission.
- b) The suspense account is in respect of the following items.

	£ ' 000'
Proceeds from the issue of 100,000 ordinary shares	120
Proceeds from the sale of plant	<u>300</u>
	420
Less consideration for the acquisition of Mary & Co	<u>285</u>
	<u>135</u>

- c) The net assets of Mary & Co were purchased on 3 March 2005. Assets were valued as follows:

	£ ' 000'
Investments	231
Inventory	<u>34</u>
	<u>265</u>

The entire inventory acquired was sold during 2005. The investments were still held by Wislon at 31.12.05. Any goodwill arising from the acquisition is considered to be impaired at the rate of 20%.

- d) The property was acquired some years ago. The buildings element of the cost was estimated at £100,000 and the estimated useful life of the assets was fifty years at the time of purchase. As at 31 December 2005 the property is to be revalued at £800,000.
- e) The plant which was sold had cost £350,000 and had a net book value of £274,000 as on the date of disposal. £36,000 depreciation is to be charged on plant and machinery for 2005.
- f) The 50p ordinary shares all rank for dividends at the end of the year.
- g) The management wish to provide for:
- i) A final ordinary dividend of 2p per share.
 - ii) A transfer to general reserve of £16,000.
 - iii) Audit fees of £4,000

The proposed dividends were declared before the year end

- h) Inventory as at 31 December 2005 was valued at £220,000 (Cost).
- i) Taxation is to be provided at £30,000. Assume a corporation tax rate of 30%

Required

Prepare the published financial statement of Wislon Co as at 31 December 2005.

Solution

Wislon Co

Income statement for the year ended 31 December 2005.

	£ '000'	£ '000'
Revenue		2,695
Cost of sales		<u>(2,194)</u>
Gross profit		501
Other income		
Gain on disposal of plant		<u>26</u>
		527
Expenses		
Distribution expenses	20	
Administration expenses	276	
Other expenses	107	
Finance costs	<u>20</u>	<u>(423)</u>
Profit before tax		104
Less income tax expense		<u>(30)</u>
Profit for the period		<u>74</u>

Wilson and Company
Statement of changes in equity for the year ended 31/12/2005

	Pref. Share Capital	Ord. Share Capital	Share Premium	Reduction Reserve	General Reserve	Retained Profits	TOTAL £ '000'
	£	£	£	£	£	£	£
Balance as at 1.1.05	100	350	-	-	171	242	863
Correction of error	-	-	-	-	-	-	-
Balance of restated	100	350	-	-	171	242	863
Gain on revaluation of PPE	-	-	-	392	-	-	392
Transfer to retained profits on sales of PPE							-
Gain on revaluation of investment							-
Foreign exchange losses/gains							-
Net gains directly reported in equity	-	-	-	392	-	-	392
Profit for the period	-	-	-	-	-	74	74
Total gains for the year	-	-	-	392	-	74	466
Issue of shares	-	50	70	-	-	-	120
Transfer to general reserve		-	-	-	(16)	(16)	-
Dividends Interim paid							
- Ordinary.						(8)	(8)
- Preference						(7)	(7)
Final proposed						-	-
Balance as at 31.12.05	100	400	70	392	187	285	1,434

Wilson Company
Statement of financial position as at 31/12/2005

	£ '000'	£ '000'
NON-CURRENT ASSETS		
Property, plant and equipment		1,098
Goodwill		16
Investment		<u>231</u>
		1,345
CURRENT ASSETS		
Inventory	220	
Trade receivable	179	
Prepayments	6	
Cash	<u>126</u>	
TOTAL ASSETS		<u><u>1,876</u></u>
EQUITY AND LIABILITIES		
Preference share capital		100
Ordinary share capital		<u>400</u>
		500
RESERVES		
Share premium	70	
Revaluation reserve	392	
General reserve	<u>187</u>	649
Retained profits		<u>285</u>
Shareholders funds		1,434
NON-CURRENT ASSETS		
10% stock		200
NON-CURRENT LIABILITIES		
Trade payables	195	
Accrued expense	17	
Current tax	<u>30</u>	<u>242</u>
TOTAL EQUITY AND LIABILITY		<u><u>1,876</u></u>

Notes to the Accounts

a) NOTE 1: Accounting Policies

These financial statements have been prepared under the historical cost basis of accounting which is modified to accommodate the revaluation of certain property. The financial statements comply with the applicable IFRSs.

- b) Property, plant and equipment is stated in the accounts at cost or revalued amount less accumulated depreciation. Depreciation is based on the estimated useful life of the assets.
- c) Inventory is stated at the lower of cost and net realizable value. Cost includes the purchase price or production cost and other expenses incurred to get the inventory ready for sale. Net realizable value is the selling price less expenses increased to complete the sale.

NOTE 2: Profit for the period (Profit before tax)

The profit for the period has been arrived at changing the following expenses:

	£ '000'	
Depreciation		38
Impairment of goodwill		4
Employee benefits:		
Salaries and wages	254	
Salesman commission	<u>20</u>	274
Auditors remuneration		4

Profit has been arrived after creating gain on proposal on disposal.

NOTE 3: Property, Plant and Equipment

Cost/Valuation	Land & Building	Plant & Machinery	TOTAL
	£ '000'	£ '000'	£ '000'
Balance as at 1.1.2004			1,260
Additions (purchases)	430	830	-
Revaluation gain	-	-	370
Disposal	<u>370</u>	<u>-</u>	<u>(350)</u>
Balance as at 31.12.2004	<u>800</u>	<u>(350)</u>	<u>1,280</u>

Depreciation

Balance as at 1.1.2004	20	222	242
Charge in the year	2	36	38
Eliminated in disposal	-	(76)	(76)
Eliminated in revaluation	<u>(22)</u>	<u>-</u>	<u>(22)</u>
Balance as at 31.12.2004	<u>-</u>	<u>182</u>	<u>182</u>

Net book value

As at 31.12.2004	<u>800</u>	<u>298</u>	<u>1,098</u>
As at 1.1.2004	<u>410</u>	<u>608</u>	<u>1,018</u>

NOTE 4: Dividends

During the year, the company paid an interim dividend of £1.14 per shares on the ordinary shares outstanding and up to the preference shares. The directors are now proposing a final dividend of 2% per share on the ordinary shares outstanding at the end of the year.

WORKINGS

	£ '000'	£ '000'
1. Cost of sales		
Opening inventory		190
Purchases	2,152	
Investment in Mary & co.	<u>34</u>	<u>2,186</u>
		2,376
Less: closing inventory		(220)
		2,156
Add: Depreciation on building (100,000 / 50)	2	
Plant	<u>3.6</u>	<u>38</u>
		2,194

2. Other income
Gain on disposal of plant

Disposal account			
Plant	350	Depreciation	76
Profit and loss	<u>26</u>	Suspense	<u>300</u>
	<u>376</u>		<u>376</u>

3. Expenses:

	Distribution	Administration	Other	Finance
Interest on loan stock				20
Wages and salaries		254		
Light and heat	20	14		
Sundry expenses			107	
Goodwill impaired		4		
Audit fees		4		
TOTAL	20	276	107	20

4. Goodwill impairment

Disposal account			
Suspense	285	Interest (statement of financial position)	231
		Purchases (stock)	34
		Goodwill	<u>20</u>
	<u>285</u>		<u>285</u>

5. PPE

	£ '000'
Land and buildings	800
Plant and machinery	<u>298</u>
	<u>1,098</u>

Land and building account			
Balance b/d	430		
Revenue reserve	<u>370</u>	Bal c/d	<u>800</u>
	<u>800</u>		<u>800</u>
Revaluation account			
Balance c/d	<u>392</u>	Land and building	370
	<u>392</u>	Land and building depr.	<u>22</u>
			<u>392</u>
Plant and machinery account			
Balance b/d	630	Disposal	350
		Balance c/d	<u>480</u>
	<u>830</u>		<u>830</u>
Land and building depreciation account			
Revenue reserve	22	Balance b/d	20
		Profit & Loss – 4 yr	<u>2</u>
	<u>22</u>		<u>22</u>
Plant & Machinery depreciation account			
Disposal depreciation	76	Balance b/d	222
Balance c/d	<u>182</u>	Profit and Loss – 4 yr	<u>36</u>
	<u>258</u>		<u>258</u>

Accrued expenses

	£ '000'
Interest on loan stock (20 – 10)	10
Light and heat	3
Audit fees	4
	17

Example 2

Auto Transmissions manufactures electrical equipments. The following trial balance as at 31 March 2005 has been extracted from the books of the company:

Ordinary shares of 50 p each	£	400,000
10% Redeemable Preference shares of £1 each		200,000
Retained profits as at 1 April 2004		42,475
Office block (Land £40,000)	170,000	
Plant and machinery	730,000	

Office equipment	110,000	
Motor vehicles	200,000	
Provision for depreciation – Plant and Machinery		224,500
- Office equipment		24,500
- Motor vehicles		80,000
Accounts receivables/Payables	500,000	356,226
Provision for doubtful debts		1,000
Manufacturing wages	501,400	
Inventory as at 1 April 2004 – raw materials	70,000	
- Work in progress	126,000	
- Finished goods	250,000	
Transport expenses	85,013	
Returns inwards	15,106	
Purchases of raw materials	518,600	
Sales		2,600,147
Bank balance		60,020
Directors salaries	60,114	
Maintenance of plant	30,102	
Rent	40,063	
Advertising	190,048	
Rates	50,171	
Insurance	20,116	
Office salaries	166,013	
Light and heat	46,027	
Factory power	30,014	
Bank interest	7,070	
Interim dividends on preference shares	10,000	
General administration expenses	<u>63,011</u>	
	<u>3,988,868</u>	<u>3,988,868</u>

Further information is as follows:

(1) Depreciation is to be provided as follows:

Plant and machinery	15% on cost. (Production expense)
Office equipment	10% on cost (administration expense)
Motor vehicles	25% on WDV (distribution cost)
New office blocks	2% on cost (Administration expense).

(2) Prepayment of rates at 31 March 2005 was £3,140.

(3) An insurance premium for public liability cover amounting to £3,360 was paid for the year to 30 June 2005.

(4) The amount owing for light and heat is £1,214 and rent is £2,321 as at 31 March 2005.

(5) Rent, rates, light and heat and insurance are to be apportioned in the ratio of 5:1 in relation to factory and office expenses.

(6) The provision for doubtful debts is to be maintained at 1% of the accounts receivables.

(7) The production director acts as a factory manager, his salary is £20,000. Office salaries include amounts paid to salesmen of £64,237.

(8) The corporation tax of £100,000 is to be provided,

(9) During the year 1,500 electrical equipments were transferred from the factory to the warehouse. Only 100 equipments were in hand at the end of the year.

(10) Inventory at cost as at 31 March 2005 was as follows:

Raw materials	£56,200.
Work in progress	£47,190.
Finished goods	?

Required:

Prepare the published income statement for the year ended 31 March 2005 and statement of financial position as at the same date. (20 marks)

Note: Do not prepare the statement of changes in equity and the notes to the accounts.

Solution**a) Classifying expenses by function****Auto transmission****Income Statement for the year ended 31/03/2005**

	£	£
Revenue		2,585,041
Cost of sales		<u>(1,586,692)</u>
Gross profit		998,349
Expenses		
Distribution expenses	373,298	
Administration expenses	244,489	
Finance costs	<u>27,070</u>	<u>(644,857)</u>
Profit before tax		353,492
Income tax expense		<u>(100,000)</u>
Profit for the period		<u><u>253,492</u></u>

b) Classifying expenses by nature**Auto Transmission**

	£	£
Revenue		2,585,041
Expenses		
Raw materials consumed	532,40	
Changes in finished goods and work in progress	233,332	
Depreciation	153,100	
Employee benefits	727,527	
Other expenses	558,120	
Finance costs	<u>27,070</u>	<u>2,231,549</u>
Profit before tax		353,492
Income tax expense		<u>(100,000)</u>
Profit for the period		<u><u>253,492</u></u>

Auto Transmission

Statement of financial position as at 31/03/2005

	£	£
NON-CURRENT ASSETS		
Property, Plant and Equipment		727,900
CURRENT ASSETS		
Inventory	198,868	
Accounts receivables	495,000	
Prepayments	<u>3,980</u>	<u>697,848</u>
TOTAL ASSETS		1,425,748
EQUITY AND LIABILITIES		
Ordinary share capital		400,000
RESERVES		
Retained profits		<u>295,967</u>
Shareholders funds		695,967
NON-CURRENT LIABILITIES		
10% Redeemable preference shares		200,000
CURRENT LIABILITIES		
Bank overdraft	60,020	
Trade payables	356,226	
Accruals	13,535	
Current tax	<u>100,000</u>	<u>529,781</u>
Total Equity and Liabilities		<u>1,425,748</u>

Workings

1. Revenue	£ 2,600,147	
Less return inwards	<u>(15,106)</u>	
	<u>2,585,041</u>	
2. Cost of sales		
Opening inventory : Finished goods		250,000
Cost of finished goods		1,682,170
Less: closing inventory of finished goods		<u>(95,478)</u>
		<u>1,586,692</u>
Factory cost of finished goods		

Manufacturing account

	£	£
Opening inventory : raw materials		70,000
Purchases of raw materials		<u>518,600</u>
		588,600
Less: Closing stock inventory raw materials		<u>(56,200)</u>
Raw materials consumed		532,400
Direct labour: Manufacturing wages		<u>501,400</u>
PRIME COSTS		<u>1,033,800</u>

Factory overheads

Directors' salaries : Factory manager	20,000	
Maintenance of plant	30,102	
Rent	35,320	
Rates	39,192.50	
Insurance	16,063	
Light and hear	39,376.50	
Factory power	30,014	
Depreciation on plant	<u>109,500</u>	<u>319,560</u>
Total cost of production		1,353,369
Add: Opening WIP		<u>126,000</u>
		1,479,369
Less: Closing W.I.P		<u>47,190</u>
Factory cost of finished goods		<u>1,432,170</u>

Value of closing stock/finished goods: $\frac{1,432,170}{1500} \times 100 = 95,478 = 95,478$

	Distribution	Administration	Finance costs
3. Expenses			
i) Transport	85,013		
ii) Directors' salaries		40,114	
iii) Rent		7,064	
iv) Advertising	190,048		
v) Rates		7,838	
vi) Insurance		3,213	
vii) Office salaries		101,776	
viii) Light and heat		7,873	
ix) Bank interest			7,070
x) Preference dividends (redeemable)			20,000
xi) Salesmen salaries	64,237		
xii) Increase in provision for bad debts	4,000		
xiii) Depreciation on - new office block		2,600	
- office equipment		11,000	
- motor vehicles	30,000		
xiv) General administration expense	<u>373,298</u>	<u>63,011</u>	<u>27,070</u>
		244,489	

Workings for classification by nature**4. Changes in finished goods and W .I. P**

	Finished goods	Work in progress	TOTAL
	£	£	£
Closing inventory	95,478	47,190	142,668
Opening inventory	<u>(250,000)</u>	<u>(126,000)</u>	<u>(376,000)</u>
Increase (decrease)	(154,522)	(78,810)	(233,332)

An increase is treated as a saving while a decrease is an expense .

5. Depreciation

Plant and machinery	109,500
New office block	2,600
Office equipment	11,000
Motor vehicles	<u>30,000</u>
	<u>153,100</u>

6. Employee benefits

Manufacturing wages	501,400
Factory manger salary	20,000
Director salaries	40,114
Office salaries	101,776
Salesman salaries	<u>64,237</u>
	<u>727,527</u>

7. Other expenses

Transport	85,013
Rent	42,384
Advertising	190,048
Rates	47,031
Insurance	19,276
Ling and heat	47,241
Plant maintenance	30,102
Factor power	30,014
Provision for bad debts	4,000
Bank interest	7,070
General administration	<u>63,011</u>
	<u>558,120</u>

8. Property, Plant and Equipment

	Cost	Depreciation to date	Net Book value
Office block	170,000	2,600	167,400
Plant and machinery	730,000	334,000	396,000
Office equipment	110,000	35,500	74,500
Motor vehicles	200,000	110,000	90,000
			<u>727,900</u>

9. Prepayments and Accruals

Prepayments		Accruals	
Rates	3,140	Light and heat	1,214
Insurance	840	Rent	2,321
		Dividend on redeemable preference shares	<u>10,000</u>
	<u>3,980</u>		<u>13,535</u>

10. Retained profits

Balance c/d	42,475
Profit for the period	<u>253,492</u>
	<u>295,967</u>

Example 2**IAS 12: INCOME TAX**

IAS 12 deals with two main types of taxes:-

- i) Corporation tax
- ii) Deferred tax

i) Corporation Tax

This is the tax payable by companies on their trading activities of a given financial period. The standard doesn't give the guidelines on how this tax should be computed because the corporation tax is based on the rules and procedures of a country with regards to tax matters.

However, once this tax has been computed then the standard gives the guidelines on how it should be treated in the financial statements.

IAS 12 requires that income tax should be shown as a separate item on the face of the income statement and described as "Income tax expense". If part of this amount remains unpaid, then it should be shown as part of current liabilities in statement of financial position and described as "Current tax".

In practice, it may be difficult for a company to know exactly how much tax should be paid in relation to a given financial period. Therefore, many companies use an estimate for the purpose of completion of the accounts.

In the subsequent financial period, the amount actually payable would be confirmed with the tax authorities and the firm may be required to pay either more than or less than what was actually provided for.

The 'the more than' or 'less than' tax is called on under or over provision of previous years tax.

IAS 12 requires that under or provision of previous year's tax should be adjusted for in the period in which it arises and thus the company shouldn't adjust its previous year's financial statements.

An underprovision of previous years tax will thus be added to the current years income tax expense and over provision of previous years tax will be deducted from the current years income tax expense and eventually the net amount shown as the income tax expense in the income statement.

Example:

During the year ended 31/12/2003, A Ltd. had estimated the corporation tax for the year to be £100,000. The amount was still outstanding as at 31/12/03. During the year ended 2004, on 30th June the actual amount payable was agreed with the tax authorities and eventually paid. Meanwhile during the year 2004, the company paid additional investment taxes of £80,000. As at the end of the year the company estimated that he payable for year 2004 will be £120,000.

Required:

Compute the income tax expense and the statement of financial position liability for year 2004 assuming that; A

- a) The actual tax paid for year 2003 was £90,000
 - b) The actual tax paid for year 2003 was £110,000.
- a) Tax for 2003 (£90,000) – Over provision of previous years tax

Profit and loss change in 2004	
Current years tax estimate	120,000
Less overprovision of previous years tax (100 – 90) '000'	<u>(10,000)</u>
Income tax expense	<u>110,000</u>

Statement of financial position liability	
Current years tax estimate	120,000
Less installment taxes paid	<u>(80,000)</u>
Current tax	<u>40,000</u>

- b) Tax for 2003 (£110,000) – Under provision of previous years tax

Profit and loss change in 2004	
Current years tax estimate	120,000
Add: underprovision of previous years tax (100 – 110)	<u>10,000</u>
Income tax expense	<u>130,000</u>

ii) Deferred tax

A company may enter into transactions in the current financial period that may result in the firm either paying or saving some tax in the future. The tax that may be paid or saved in the future is called **deferred tax** that may be paid in the future is called **deferred tax liability** whereas tax that may be saved in the future is called **deferred tax asset**.

Previously accountants used to compute deferred tax using the income statement approach. Under this approach, the difference between profit before tax and taxable profits was simply referred to as a **difference**. This difference was classified into permanent and temporary timing differences.

Permanent differences related to those items that are adjusted for tax in the current year and will never be adjusted for tax in the future E.g. Donations to political parties.

Temporary/timing differences relate to those items that are adjusted in the current period and are again adjusted in subsequent financial periods for tax purposes. E.g. investment income accrued in profits before tax will be deducted in the current period for tax purpose but will be added back in subsequent financial periods when investment income is received.

All temporary differences therefore result to deferred tax

However, currently the computation of deferred tax is based on the statement of financial position approach whereby temporary differences are given as the difference between the carrying amount of an asset or liability (book value) and its tax base.

The **carrying amount** is the accounting value or book value of an asset or liability. The **tax base** is the value attributable to asset or liability for tax purpose.

Example;

A firm bought an item of plant at a total amount of £50,000. During the first year, the firm provided for depreciation of 10,000. The item of plant has a capital allowance of £15,000 for the first year.

Re. Compute the carrying amount of the asset, the tax base and hence the temporary difference.

Carrying amount	cost – depreciation =50,000-10,000 =40,000
Tax base	cost – capital allowance =50,000-15,000 =35,000
Temporary differences	carrying amount – tax base =40,000-35,000 =£5,000

There are two main types of temporary differences;

i) Taxable temporary difference

If the carrying amount is more than the tax base then it means that this difference is taxable and the firm will end up paying some tax in the future. Therefore all taxable temporary differences lead to **deferred tax liability**.

ii) **Deductible temporary differences**

If the tax box is more than the carrying amount, then the firm will end up saving some tax in the future because the amounts due from the tax authorities will be deducted from the future taxes. Therefore, all deductible temporary differences will lead to **deferred tax assets**.

Accounting treatment of deferred tax

The objective of accounting for deferred tax is to ensure that the profits for the period do not fluctuate due to temporary differences. To achieve this objective, an account called deferred tax account is prepared upon which adjustments are made at the end of every financial period.

The approach is normally to compute the temporary differences. Thereafter we apply the corporation tax rate on the temporary difference to get the balance carried down in the deferred tax account. The balance carried down is compared with the balance brought down and the difference being the balancing figure in the deferred tax account represents **a transfer to or from the profit and loss or income statement**.

The transfer to or from the profit and loss is not debited or credited directly in the income statement but adjustments are made on the income tax expense whose net amount will now appear in the income statement.

The final figure for income tax expense that will appear in the income statement will be arrived as follows:-

	£
Current year estimated corporation tax	x
Add/(less) under cover provision of previous years tax	x/(x)
Add/(Less) transfer to (from) deferred tax account	<u>x/(x)</u>
Income tax expense	<u><u>xx</u></u>

In the statement of financial position, deferred tax liability will be shown under NON-CURRENT LIABILITIES. Whereas a deferred tax asset will be shown under NON-CURRENT ASSETS.

Example

A Ltd., bought an item of plant at a cost of £100,000 in year 2000. The estimated useful life of the plant was 5 years and depreciation is on a straight line basis with no residual value. The company makes profits before tax of £200,000 and the corporation tax rate is 30%. The item of plant has the following:

Year	1	2	3	4	5
Rate	30%	25%	20%	15%	10%

Required: (for each of the five years)

- i) Tax liability (corporation)
- ii) Carrying amount, tax base, taxable temporary difference of the plant and the balance carried down on deferred tax account.

- iii) The deferred tax account
 iv) Final accounts extracts (Profit and loss + statement of financial position)
 Assume that the corporation tax liability is unpaid by the year end.

Corporation tax liability

	2000	2001	2002	2003	2004
	£	£	£	£	£
Profit before tax	200,000	200,000	200,000	200,000	200,000
Add back depreciation	<u>20,000</u>	<u>20,000</u>	<u>20,000</u>	<u>20,000</u>	<u>20,000</u>
	220,000	220,000	220,000	220,000	220,000
Less capital allowances	<u>(30,000)</u>	<u>(25,000)</u>	<u>(20,000)</u>	<u>(15,000)</u>	<u>(10,000)</u>
Taxable profits	<u>190,000</u>	195,000	200,000	205,000	210,000
Taxable liability (30%)	<u>(57,000)</u>	<u>(56,500)</u>	<u>(60,000)</u>	<u>(61,500)</u>	<u>(63,000)</u>
	133,000	136,500	140,000	143,500	147,000

Carrying amount, tax base, and taxable temp diff.

	2000	2001	2002	2003	2004
	£ '000'	£ '000'	£ '000'	£ '000'	£ '000'
Carrying amount: Cost	100	100	100	100	100
Accumulated depreciation	<u>20</u>	<u>40</u>	<u>60</u>	<u>80</u>	<u>100</u>
	<u>80</u>	<u>60</u>	<u>40</u>	<u>20</u>	<u>-</u>
Tax box: Cost	100	100	100	100	100
Accumulated capital all	<u>(30)</u>	<u>(55)</u>	<u>(75)</u>	<u>(90)</u>	<u>(100)</u>
	<u>70</u>	<u>45</u>	<u>25</u>	<u>10</u>	<u>-</u>
Taxable temp. difference	10	15	15	10	-
Bal c/d on deferred tax a/c (30%)	3	45	45	3	-

Deferred Tax Account

	£ '000'		£ '000'
31/12/00 Bal c/d	<u>3</u>	31/12/00 P & L (bal. fig)	<u>3</u>
31/12/01 Bal c/d	4.5	1/1/01 Bal b/d	3
		31/12/01 P & L (bal. fig)	1.5
	<u>4.5</u>		<u>4.5</u>
31/12/02 Bal c/d	<u>4.5</u>	1/1/02 Bal b/d	<u>4.5</u>
31/12/03 P & L (Bal. fig)	4.5	1/1/03 Bal b/d	4.5
31/12/03 Bal c/d	1.5		
	3		
	<u>4.5</u>		<u>4.5</u>
	<u>3</u>	1/1/04 Bal b/d	<u>3</u>

Final accounts extracts

Income statement

	2000	2001	2002	2003	2004
	£ '000'	£ '000'	£ '000'	£ '000'	£ '000'
Profit before tax	200	200	200	200	200
Income tax	<u>60</u>	<u>60</u>	<u>60</u>	<u>60</u>	<u>60</u>

Profit for the period	<u>140</u>	<u>140</u>	<u>140</u>	<u>140</u>	<u>140</u>
-----------------------	------------	------------	------------	------------	------------

Workings: Income tax expense

Current year estimated corporation tax liability	57	58.5	60	61.5	63
Add/(less) transfer to/(from) deferred tax a/c	<u>3</u>	<u>1.5</u>	<u>-</u>	<u>(1.5)</u>	<u>(3)</u>
	60	60.0	60	60	60

Statement of financial position

NON-CURRENT LIABILITIES					
Deferred tax	3	4.5	4.5	3	-
CURRENT LIABILITIES					
Current tax	57	58.5	60	61.5	63

IAS 8: ACCOUNTING POLICIES CHANGES IN A ACCOUNTING ESTIMATES AND ERRORS

The objective of IAS 8 is to recommend the accounting statement of accounting policies changes in accounting statements and errors.

Accounting policies

Accounting policies are the specific assumptions, bases, principles and practices that are adopted by firms in preparing financial statements. The standard requires that companies follow the policies consistently from one financial period to the next.

A company should be guided by accounting standards or the current practices in choosing and applying accounting policies. The standard allows firms to change their accounting policies when;

- i) There is new standard
- ii) The change is required by the law
- iii) The new change will result in a fair presentation of the financial performance and position.

When a company changes its policies, then the change should be accounted for retrospectively i.e. the previously reported financial statements should be adjusted/restated to reflect the new policy for comparison purposes.

Example:

A Ltd., has decided to change its policy of writing off borrowing costs to capitalizing the same. As at 31st December, 2003, the company had written off borrowing costs amounting to £200,000. During the year ended 31/12/04. The company reported profit for the period of £450,000 but after charging borrowing costs of £50,000. As at 31/12/03 the retained profits were £1,500,000. Other transactions were:-

- Transfer from revaluation reserve on sale of PPE - £40,000
- Transfer from retained profits to general reserve - £50,000
- Interim dividends paid - £200,000

Required: Prepare the statement of changes in equity extract for the year-ended 31/12/04

	Retained profits
	£
Balance as at 1.1.2004	1,500,000
Change in accounting policy	<u>200,000</u>
Balance as restated	1,700,000
Transfer from revaluation reserve on sale of PPE	40,000
Profit for the period (450,000 + 50,000)	500,00
Transfer to general reserve	(50,000)
Interim dividends paid	<u>(200,000)</u>
Balance as at 31/12/2004	1,990,000

Changes in accounting estimates

In preparing financial statements, it may be difficult to arrive at exact values for certain items to be presented in the financial statements and thus estimates are normally used.

Examples of estimates: Depreciation, provision for doubtful debts and other provisions in relation to contingent liabilities e.g. pending court cases (suits)

These estimates are based on the available information as at the time of preparing financial statements.

However, in subsequent financial periods, changes may be required on these estimates because of new information becoming available. IAS 8 requires that a change in accounting estimate should be accounted for in the period in which the change arises and where relevant, in other subsequent financial period. E.g. an increase or decrease in provision for doubtful debts will be adjusted for in the current years income statement whereas depreciation will not only be adjusted for in the current year but also in the subsequent financial periods. i.e. the remaining Net Book Value of the assets will be depreciated over the remaining useful life starting with the current financial period.

Example:

B Ltd., bought an item of plant at a total cost of £100,000. The estimated useful life commencing from 1st January 2000 was 10 years. At the start of the 4th year it was discovered that the actual estimated useful life of the plant was 8 years and not 10 years.

Required: Compute the depreciation charge for each of the eight years on the plant.

$$\begin{aligned} \text{Initial depreciation} &= \frac{100,000}{10} \\ &= \text{£}10,000 \text{ each for 3 years} \end{aligned}$$

$$\begin{aligned} \text{Net Book Value at beginning of year 4} \\ &= 10,000 \times 3 \text{ years} = 30,000 \\ &= 100,000 - 30,000 = 70,000 \end{aligned}$$

depreciation for rest of the 5 years

$$= \frac{70,000}{5}$$

$$= \text{£} 14,000$$

Errors

An error is an error discovered in the current financial period but it relates to one or more previous financial periods. Such errors arise due to mathematical mistakes, misapplication of accounting policies, oversights and fraud.

The statement requires that if such an error is material i.e. the previously reported financial statements were materially misstated or misrepresented, then, the opening balances of the current financial period must be restated and if practical, the previous financial statements should be restated. Therefore an error requires retrospective application.

Example:

ABC Ltd., reported the following transactions during the year ended 31/12/2004

Retained profits b/d	£100,000
Transfer from revaluation reserve	£20,000
Transfer to general reserve	£15,000
Profit for the period	£60,000
Interim dividends paid	£20,000

After the above balances were extracted, new information came to light that the opening inventory was overstated by £10,000 due to double counting of some stock items.

Required: Prepare the statement change in equity extract for the year ended 31st December 2004.

	Retained profits £
Balance as at 1.1.04	100,000
Error	<u>(10,000)</u>
Balance restated	90,000
Transfer from revaluations reserve	20,000
Profit for the period (60,000 + 10,000)	70,000
Transfer to general reserve	(15,000)
Interim dividends paid	<u>(20,000)</u>
Balance as at 31.12.04	<u>145,000</u>

Example 3

The authorized share capital of Shirika Jipya Limited consists of 75,000 redeemable preference shares of Sh.10 each and 1,500,000 ordinary share of Sh.25 each. The former are to be redeemed during 2005.

The trial balance of Shirika Jipya Limited as at 30 June 2000 was as follows:

	Sh. '000'	Sh. '000'
Ordinary Share capital (shares fully paid)		15,375
6% redeemable preference share capital		750
Share premium account		3,150
Income statement (1 July 1999)		21,600
10% convertible loan stock		8,000
Deferred tax		1,080
Inventories (1 July 1999)	25,073	
Trade receivable	34,979	
Trade payables		25,425
Provision for doubtful debts		90
Wages and salaries payable		473
Value added tax payable		681
Interim dividend paid	430	
Freehold land, at cost	848	
Building at cost	5,100	
Plant at cost	30,750	
Provision for depreciation on building		398
Provision for depreciation on plant		12,059
Long-term investment quoted	3,525	
Interest paid	450	
Purchases	141,450	
Preferred dividend paid	32	
Profit on sale of plant		173
Bad debts	23	
Sales		179,100
Dividend received from investments (gross)		300
Installment tax and withholding tax paid	738	
Wages and salaries	24,450	
Bank	806	
	<u>268,654</u>	<u>268,654</u>

Additional information:

1. The 10% convertible loan stock is secured against the plant.
2. (i.) During the year fixed assets were purchased as follows
Buildings Sh.750,000 and plant Sh.4,050,000.
(ii). Plant with an original cost of Sh.1,500,000.
3. Depreciation is to be charged as to buildings Sh.53,000 and plant Sh.690,000.
4. The quoted investments had a market value at 30 June 2000 of Sh.6,750,000.
5. The wages and salaries figure includes the following:

Directors Salaries	122,00
General Manager	33,000
Company Secretary	23,000
6. The firm had signed a contract for Sh.23,243,000 being the lower of cost and net realisable value.
7. Sh.75,000 needs to be transferred from the deferred tax account.
8. The stock as at 30 June 2000 was Sh.23,243,000 being the lower cost and net realisable value.
9. The following provisions need to be made:

- (i). Audit fees of Sh. 53,000
- (ii). A final dividend on ordinary shares of Sh.35 per share. This had been proposed before the year end.
- (iii). The provision of doubtful debts is to be adjusted to Sh.120,000.
- (iv). Corporate tax of the year's profit is estimated at Sh. 4,290,000. Last year's tax was Overestimated by Sh.15, 000: this figure had been netted off against the installment and withholding tax paid.
10. After payment of the preference dividend in March 2000, the company decided to redeem these shares and this was done in June 2000. No entries have been made in the books in respect of the same. The shares were redeemed at a premium of 5% and this is to be written –off in the share premium account.

Required:

- (a) An Income Statement (using the cost of sales method: do not attempt to classify expenses according to their functions). (8 marks)
- (b) A statement of Changes in Equity for the year ended 30 June 2000. (8 marks)
- (c) Statement of financial position as at that date in a form suitable for publication and conforming (as far as the information permits) with the requirements of the Companies Act and International Accounting Standards. (9 marks)

(Total: 25 marks)**Solution****Shirika Jipya****Income statement for the year ended 30 June 2000**

	Sh.000	Sh.000
Turnover		179,100
Cost of sales (W1)		<u>(143,023)</u>
Gross profit		35,077
Other operating income: Profit on disposal	173	
Investment income	<u>300</u>	<u>473</u>
Expenses		35,550
Other expenses (W)	24556	
Finance cost	<u>832</u>	<u>(25,388)</u>
Profit before tax		10,162
Income tax expense		<u>(4,200)</u>
Profit for the period		<u>5,962</u>

Shirika jipya**Statement of changes in equity for the year ended 30 june 2000**

	Ordinary share capital Sh.'000'	Share Premium Sh.'000'	Capital redemption reserve Sh.'000'	Investment revaluation Sh.'000'	Retained Profits Sh.'000'	Total Sh.'000'
Bal as at 1.7.99	15,375	3,150	-		21,600	40,125
	-	-	-		-	-
	15,375	3,150	-		21,600	40,125
Gain on inv. revaluation	-	-	-		-	-
	-	-	-	3225	-	-3225
	-	-	-		-	-
	-	-	-		-	-
Purchase of shares	-	(37.5)	-		-	(37.5)
Transfer to CRR	-	-	750		(750)	-
Profit for year	-	-	-		5,962	5,962
Dividends:						
Interim (W4)	-	-	-		(430)	(430)
	-	-	-			-
	<u>15,375</u>	<u>3,112.5</u>	<u>750</u>	<u>3225</u>	<u>26362</u>	<u>48844.5</u>

Shirika Jipya**Statement of financial position as at 30 June 2000**

	Sh.000	Sh.000
NON CURRENT ASSETS		
Plant, property and equipment (Note 4)		23,498
Investments		<u>6750</u>
		30248
CURRENT ASSETS		
Inventory	23,243	
Receivables (W6)	34,859	
Bank (W7)	<u>18.5</u>	<u>58,120.5</u>
		<u>88368.5</u>
FINANCED BY		
Authorised share capital		37,500
1.5m ordinary shares @ Sh.29		<u>750</u>
75,000 preference shares @ Sh.10		<u>38,250</u>
ISSUED AND PAID UP		
Ordinary share capital		15,375
Capital redemption reserve	750	
Share premium	3,112.5	
	<u>3,225</u>	7,087.5
Investment revaluation		<u>26,382</u>
Retained profits		48,844.5
Shareholders funds	8,000	
	<u>1,005</u>	9,005
Non Current Liabilities		
Loan stock	25,425	
Deferred tax	1,557	
	<u>4,537</u>	
Current liabilities		
Creditors		<u>30,519</u>
Accruals (W8)		88368.5
Accrued tax (W9)		

Notes to the Financial Statements

- The above financial statements have been prepared under the historical basis of accounting which is modified to accommodate revaluation of certain assets. They are in compliance with the applicable **IFRSs** and the Company's Act..
- The profit for the period has been arrived at after charging:

	Sh.000
Directors fee	122

Depreciation	743
Auditors remuneration	53
Staff costs	24328

3. The tax expense for the year is arrived at by applying the corporate rate of tax in Kenya of 30% to the adjusted profit for the year.

4. **Property, plant and Equipment**

	Land Sh.'000'	Buildings Sh.'000'	Plant Sh.'000'	Total Sh.'000'
Cost/valuation				
Bal b/d	848	28,200	4,350	33,398
Additions	-	4,050	750	4,800
Disposal	-	(1,500)	-	(1,500)
Bal c/d	<u>848</u>	<u>30,750</u>	<u>5,10</u>	<u>46,698</u>
Depreciation				
Bal b/d	-	13,214	398	13,612
Eliminated and disposed	-	(1,155)	-	(1,155)
Charge for year	-	690	53	743
Bal c/d	<u>-</u>	<u>12,749</u>	<u>451</u>	<u>13,200</u>
NBV c/a	<u>848</u>	<u>18,001</u>	<u>4,649</u>	<u>23,498</u>
NBV b/d	<u>848</u>	<u>14,986</u>	<u>3,952</u>	<u>19,786</u>

5. The 10% loan stock is secured against the plant.
6. The firm has signed a contract of Sh.8.775m for the construction of a warehouse for storage of goods.

Workings

1.	Cost of sales	25,073
	Opening stock	<u>141,450</u>
	Purchases	166,523
	Closing stock	<u>(23,243)</u>
		<u>143,280</u>
	Add: Depreciation on:	
	• Buildings	53
	• Plant	690
		<u>144023</u>
	Finance cost	
2.	Debenture interest (10% x 8,000)	<u>800</u>
	Paid	450
	Accrued	<u>350</u>
		800
	Add: Preference share dividend paid	<u>32</u>
		<u>832</u>

3.	Other expenses	30
	Increased provision (bad debts)	53
	Audit fee	24,450
	Wages and salaries	<u>23</u>
	Bad debts	<u>24556</u>
4.	Interim dividends	
	Ordinary share capital	430
	Preference share capital	<u>32</u>
		<u>462</u>
5.	Income tax expense	
	Current years estimate	4,290
	Less previous years overprovision	(15)
	Transfer from deferred tax	<u>(75)</u>
		<u>4,200</u>

Note: Under IAS 32 redeemable preference shares are treated as a non current liability. Therefore any dividends paid thereon are finance costs and it will not appear as aprt of shareholders funds.

		Sh.000
5.	Final dividends $\left(35 \times \frac{15,375}{25}\right)$	21,525
	Preference share capital (6% x 750 – 32)	<u>13</u>
		<u>21,538</u>
6.	Receivables = (34,979 – 120)	34,859
7.	Bank: As per TB	806
	Paid for redemption	<u>(787.5)</u>
		<u>18.5</u>
8.	Accruals	
	Wages	473
	VAT	681
	Interest	350
	Audit fee	<u>53</u>
		<u>1,557</u>
9.	Accrued tax	
	Estimated for year	4,290
	Overestimated	(15)
	Paid	<u>(738)</u>
		<u>3,537</u>

Deferred Tax A/c

		Sh.000			Sh.000
	Sh.000				
Profit & Loss	75				
C/d	<u>1,005</u>		Bal b/d		<u>1,080</u>
	<u>1,080</u>				<u>1,080</u>

Example Four

Viatu Ltd, which manufactures footwear, makes up its accounts to 31 March each year. The company has an authorised share capital of Sh. 600,000,000 divided into 15,000,000 6.5% preference shares of Sh. 20 each and 30,000,000 ordinary shares of Sh. 10 each. The following trial balance was extracted as at 31 March 2002.

Trial balance as at March 2002

	Sh000	Sh:000
Cost of Sales	699,992	
Motor vehicle expenses	59,684	
Selling and distribution costs	78,840	
Depreciation of motor vehicles – for the year	12,580	
Wages and salaries	95,834	
Administration expenses	11,492	
Audit fees	1,400	
Sales		1,191,864
Discounts received		812
Investment income – trade investments		1,072
- others		1,608
Preference dividends paid	13,000	
Debenture interest	1,600	
Corporation tax paid – instalment	8,615	
Compensation to director for loss of office	8,500	
Depreciation of fixtures for the year)	1,040	
8% debentures		20,000
Cash in hand	3,000	
Ordinary share capital issued and paid-up)		200,000
Bank balance	11,745	
Preference share capital issued and paid-up)		200,000
Inventory 31 March 2002)	204,132	
Debtors/creditors	336,440	102,000
Deferred tax		3,000
Motor vehicles net book value)	24,800	
Provision for doubtful debts		14,400
Fixtures and fittings net book value)	11,300	
Income statement 1 April 2001)		110,848
General reserves		60,000
Share premium		40,000
Freehold land and building cost)	270,000	
Investments – trade market value Sh.35,000,000)	30,000	
Others market value Sh.62,000,000)	61,610	
	<u>1,945,604</u>	<u>1,945,604</u>

Additional information:

1. Wages and salaries include salary paid to Managing Director of Sh. 30,000,000 and salary paid to Sales Director of Sh. 25,000,000.
2. Provision is due to be made for directors' fees Sh. 150,000,000.
3. Provision for doubtful debts is to be adjusted to Sh. 16,822,000.
4. Timing differences of Sh. 4,000,000 are expected to reverse in the near future.
5. The directors recommended an ordinary dividend of Sh.1.35 per share.

6. Corporation tax for the year is Sh.11; 820,000. The corporation tax rate is 30% on adjusted profit.
7. Land and buildings were professionally valued at Sh.300,000,000 at the year end. The directors wish to incorporate the valued amount in the financial statements.
8. Information about other fixed asset is as follows:

	Motor vehicles Sh	Fixtures & fittings Sh
Cost (including additions during the year)	51,200,000	20,800,000
Additions during the year	2,240,000	1,600,000
Cost of assets disposed of during the year (No entry made yet)	2,800,000	1,455,000
Accumulated depreciation of asset disposed of during the year	2,150,000	905,000
Proceeds of asset disposed of (including in sales in the trial balance)	715,000	500,000

Required

- (a) Income statement for the year ended 31 March 2002 (13 marks)
- (b) Statement of financial position as at 31 March 2002 (12 marks)

(The above two statement should be presented in the form suitable for publication in accordance with the requirements of International Accounting Standards .IASs)

Solution

Viatu Ltd

Income statement for the year ended 31 March 2003

	Sh.'000'	Sh.'000'
Turnover (W1)		1,190,694
Cost of sales		<u>(699,922)</u>
Gross profit		490,657
Other Incomes : Discount received	812	
Profit on disposal	15	
Investment income	<u>2,680</u>	
		<u>3,507</u>
Selling and distribution expenses	176,104	
Administrative expenses	245,688	
Finance costs	<u>1,600</u>	
Profit before tax		70,772
Income tax expense: Current	11,820	
Deferred	<u>(1,800)</u>	
Profit for the period		<u>60,752</u>

Viatu Ltd
STATEMENT OF CHANGES IN EQUITY AS AT 31.03.02

	Ordinary share capital Sh.'000'	Preference share capital Sh.'000'	Share premium Sh.'000'	General reserve Sh.'000'	F.A Rev. Reserve Sh.'000'	Retained earnings Sh.'000'	Total Sh.'000'
Bal b/f	200,000	200,000	400,000	600,000	-	110,848	610,848
Prior adjustment	-	-	-	-	-	-	-
Restated	200,000	200,000	400,000	600,000	-	110,848	610,848
Rev. gain on NCA	-	-	-	-	30,000	-	30,000
Rev. gain on investment	-	-	-	-	390	-	390-
Rev. gain on foreign	-	-	-	-	-	60,752	60,752
Net profit: year	-	-	-	-	-	-	-
Dividends: Interim	-	-	-	-	-	(13,000)	(13,000)
							-
Bal b/d	<u>200,000</u>	<u>200,000</u>	<u>400,000</u>	<u>600,000</u>	<u>30,390</u>	<u>158,600</u>	<u>68,8990</u>

(b) **Viatu Ltd**
Statement of financial position as at 31 March 2002

	Sh.'000'	Sh.'000'
<u>Non Current Assets</u>		
Plant, property and equipment		334,900
Investments(Other)		<u>62000</u>
		396900
<u>Current Assets</u>		
Inventory	204,132	
Receivables (336,440 – 16,822)	319,618	
Trade investments	30,000	
Cash and bank (11,745 + 3,000)	14,745	
		<u>568,495</u>
		<u>965395</u>
FINANCED BY:		
<u>Authorised share capital</u>		
15m shares 6.5% preference @ Sh.20		300,000
50m share ordinary @ Sh.10		<u>300,000</u>
		<u>600,000</u>
<u>Issued and fully paid</u>		
10m 6.5% preference shares @ Sh.20		200,000
20m Ordinary shares @ Sh.10		<u>200,000</u>
		400,000
<u>Reserves</u>		
Share premium	40,000	
Revaluation reserve	30,390	
General reserve	60,000	
Retained profit	<u>158,600</u>	
Shareholders funds		688,990
<u>Non current liabilities</u>		
8% debentures	20,000	

Deferred tax	<u>1,200</u>	<u>21,200</u>
		710190
Current liabilities		
Trade creditors	102,000	
Tax payable (11,820 – 8,615)	3,205	
Accrued directors' fee	<u>150,000</u>	<u>255,205</u>
TOTAL EQUITY AND LIABILITIES		<u>965395</u>

Workings

1.	Turnover		Sh.'000'
	As per trial balance		1,191,864
	Less proceeds and disposals		<u>(1,215)</u>
			<u>1,190,649</u>
2.	Selling and distribution costs		
	As per TB		78,840
	Motor vehicle expenses		59,864
	Wages		25,000
	Depreciation: Motor vehicle		<u>12,580</u>
			<u>176,104</u>
3.	Administrative expenses		
	Wages and salaries		70,834
	As per TB		11,492
	Audit fees		1,400
	Depreciation: fixtures		1,040
	Compensation of director for loss of office		8,500
	Provision for doubtful debts (16,822 – 14,400)		2,422
	Director's fee		<u>150,000</u>
			<u>245,688</u>
4.	Profit on assets disposed		
		<u>Motor vehicles</u>	<u>Fixtures & Fittings</u>
	Cost	2,800	1,455
	Acc. Dep.	<u>2,150</u>	<u>905</u>
	NBV	650	550
	Proceeds	<u>715</u>	<u>500</u>
	Profit & Loss		<u>6,500</u>

DEFERRED TAX A/C

	Sh.'000'		Sh.'000'
Profit U Loss	1,800		
Bal c/d (30% x 4,000)	<u>1,200</u>	Bal b/d	<u>3,000</u>
	<u>3,000</u>		<u>3,000</u>

Notes to the accounts**Note 1 Accounting policies**

These financial statements have been prepared under the historical cost basis of accounting, which is modified to accommodate the revaluation of certain properties and in accordance with the applicable IFRSs.

Property plant and equipment is shown at cost or revalued amount less the total accumulated depreciation which is based on the estimated useful life of the assets.

Inventory has been stated at the lower of cost and net realisable value.

Note 2 Profit before tax

The profit before tax has been arrived at after charging the following expenses

	Sh.'000'
Directors fee	205,000
Compensation to director for loss of office	8,500
Depreciation	13,650
Auditors fee	1,400
Staff costs	40,834

Note 3 Taxation

Corporation tax is based on the adjusted profits for tax purpose at a corporation tax rate of 30%

Note 4 Property plant and equipment

COST/VALUATION	Freehold land & Buildings Sh.'000'	Motor vehicles Sh.'000'	Fixtures & Fittings Sh.'000'	Total Sh.'000'
Bal as at 01.04.01	270,000	48,960	19,200	338,160
Additions	-	2,240	1,600	3,840
Disposals	-	(2,800)	(1,455)	(4,255)
Revaluations	<u>30,000</u>	<u>-</u>	<u>-</u>	<u>30,000</u>
Bal as at 31.03.02	<u>300,000</u>	<u>48,400</u>	<u>19,345</u>	<u>367,745</u>
Accumulated Depreciation				
Bal as at 01.04.01	-	13,820	8,460	22,280
Eliminated on disposal	-	(2,150)	(905)	(3,055)
Charge for the year	<u>-</u>	<u>12,580</u>	<u>1,040</u>	<u>13,650</u>
Bal as at 31.03.02	<u>-</u>	<u>24,250</u>	<u>8,595</u>	<u>32,845</u>
NBV as at 31.03.02	<u>300,000</u>	<u>24,150</u>	<u>10,750</u>	<u>315,880</u>
NBV as at 01.04.01	270,000	35,140	10,740	315,880

Note 5 Dividends

During the year the company paid a dividend of sh.1.30 on the preference shares outstanding. The directors are now proposing a dividend of sh.1.35 per s share on the number of ordinary shares outstanding at the end of the year.

REINFORCEMENT QUESTIONS

QUESTION ONE

Athi River Cement (ARC) Ltd. is a company quoted on the Nairobi Stock Exchange. It makes up its accounts to 31 March each year. The balance of the company as at 31 March 2003 is as follows:

	Sh. Million	Sh. Million
Administrative expenses	99	
Borrowings		103
Buildings: Valuation at 1 April 1998	180	
Accumulated depreciation		30
Capital work in progress	74	
Cash and bank balances	5	
Cost of sales	601	
Compensating tax payable		8
Deferred income taxes		151
Deferred expenditure	15	
Distribution costs	109	
Finance leases payable		7
Finance costs	27	
Finance income		2
Inventories	186	
Other operating expenses	3	
Other operating income		4
Plant and machinery: Cost	907	
Accumulated depreciation		283
Prepaid operating lease rental: Cost	80	
Amortisation of prepaid operating lease rental		20
Revaluation reserve		110
Share capital		450
Share premium		188
Taxation	17	
Turnover (net of VAT)		884
Trade and other payables		160
Trade and other receivables	194	
Revenue reserve		95
Unclaimed dividends		<u>2</u>
	<u>2,497</u>	<u>2,497</u>

Additional information

- | | | |
|----|--|-------------------|
| 1. | Borrowings comprise: | |
| | Bank overdraft (interest are payable in the year 20%) | Sh.million |
| | Bank loan, repayable 31 March 2005 (interest rate 13% fixed) | 53 |
| | | <u>50</u> |
| 2. | Buildings: Historical cost | <u>103</u> |
| | Depreciation charge for the year included in cost of sales | <u>60</u> |
| | | 6 |

ARC's accounting policy in relation to the difference between depreciation based on the revalued amount of buildings (Sh.6 million) and depreciation based on the buildings' historical cost (Sh.2 million) is to treat it as revaluation surplus realized as the buildings are used. This transfer for the year has not yet been made.

The buildings had been revalued by Roy and Samika, Registered Valuers and Estate Agents, on an open market basis.

Accumulated depreciation on historical cost of buildings as at 31 March 2003 was Sh.20 million

No impairment losses have occurred in the life of the company

3. Capital work in progress relates to ongoing construction of a new kin.
4. The compensating tax payable was in respect of the previous year's dividend paid in the year.
The directors have proposed that a dividend of 10% be paid for the year ended 31 March 2003. No entry has been made in the financial statements to reflect this. Proposed dividends are accounted for as a separate component of equity until they have been ratified at a general meeting.
5. Deferred expenditure represents development costs relating to production of new products that are written off over four years. Expenditure of Sh.20 million was incurred early in the year to 31 March 2003. The amortisation charge for the year was Sh.5 million.
6. The tax expense for the year is as follows:
- | | Sh. Million |
|--|-------------|
| Current taxation based on adjusted profit at 30% | - |
| Deferred tax expense | <u>17</u> |
| | <u>17</u> |
| Ignore deferred tax on the revaluation surplus | |
7. Finance lease payable comprise:
- | | Minimum
lease
payments | Present value
of minimum
lease payments |
|---|------------------------------|---|
| | Sh. Million | Sh. Million |
| Payable within one year | 3 | 5 |
| Payable later than one year but not later than five years | <u>8</u> | <u>5</u> |
| | <u>11</u> | <u>7</u> |
8. Finance costs comprise:
- | | |
|----------------------------|-----------|
| Interest on bank loan | 9 |
| Interest on bank overdraft | 16 |
| Interest on finance leases | <u>2</u> |
| | <u>27</u> |
9. Finance income:
- | | |
|------------------------------------|----------|
| Interest received on bank deposits | <u>2</u> |
|------------------------------------|----------|
10. Inventories comprise:
- | | |
|-------------------|------------|
| Raw materials | 48 |
| Work in progress | 29 |
| Finished goods | 51 |
| Stores and spares | <u>58</u> |
| | <u>186</u> |

11. The depreciation charge for the year on the plant and machinery was Sh.52 million and the amortisation charge of the prepaid operating lease rental was Sh.2 million
All depreciation and amortisation charges are included in cost of sales
12. Other expenses included in the various functional expenses or cost of sales are:
- | | Sh. Million | Sh. Million |
|---------------------------------------|-------------|-------------|
| Directors' emoluments: Fees | 2 | |
| Other emoluments | <u>12</u> | 14 |
| Other staff costs: Wages and salaries | 81 | |
| Social security cost (NSSF) | 2 | |
| Termination benefits | <u>3</u> | 86 |
| Auditors' remuneration | | 2 |
| Loss on disposal of motor vehicles | | <u>3</u> |
| | | <u>105</u> |
- The average number of staff employed by the company during the year was 603.
13. The authorized share capital of the company is made up of 90 million ordinary shares of Sh.5 each.

Required:

Prepare the Income Statement and the Statement of Changes in Equity for the year ended 31 March 2003 and the Statement of financial position as at 31 March 2003. ARC Limited prepares its Statement of financial position showing Total Assets and Total Equity and Liabilities. Any notes necessary to ensure that the Financial Statements are prepared in accordance with International Financial Reporting Standards should be added, but using only the information included above. Do not compute the Earnings Per Share for the year.

QUESTION TWO

Maina and Ojara have been in partnership for a number of years sharing profits in the ratio 3:2. Because of the present difficult economic situation in the country, it has been agreed that in the period ended 30 April 2000, no salaries will be paid to the partners and no drawings will be made either. Interest has been credited to the partners in respect of their capital accounts. They decided to turn the partnership into a company on 30 April 2000, with its accounts being made up to 30 April each year. They decided that they would not open a separate set of accounts on 30 April 2000, but would continue to record the transactions of the business in the partnership books.

The trial balance extracted by the accountant, after he had computed the profit for the period ended 30 April 2000 and the year ended 30 April 2001, was as follows

	Sh. '000'	Sh. '000'
Capital accounts at 1 November 1999:		
Maina		1,350
Ojara		750
Net profit before tax: period to 30 April 2000		495
Operating profit before interest and tax: year to 30 April 2001		1,680
210,000 ordinary shares of Sh. 10 each, fully paid up		2,100
20% debentures		450
Stock and work-in progress	1,140	
Trade receivables	1,515	
Cash at Bank and in hand	405	
Interim dividend paid on 28 February 2001	300	
Trade payables		1,530

Purchase consideration for company	2,850	
Land and buildings	900	
Plant and machinery	900	
Vehicles	540	
Depreciation: Land and buildings		30
Depreciation: Plant and machinery		90
Depreciation: Vehicles		135
Loss on revaluation of net assets as at 30 April	<u>60</u>	
	8,610	8,610

Additional information:

1. The fair values of the identifiable assets and liabilities of the partnership at 30 April 200 were:

	Sh. '000'
Land and buildings	900
Plant and machinery	900
Vehicles	540
Stock	480
Trade receivables	1,470
Cash at Bank and in hand	750
Trade payables	<u>(2,505)</u>
	2,535

These fair values recorded in the books on 30 April and were the basis used for computing the purchase consideration payables to the partners. Depreciation for the year ended 30 April 2001 has been provided for based on these figures.

2. The purchase consideration of Sh. 2,858,000 was satisfied by the issue of 210,000 ordinary shares of Sh. 10 each, Sh. 450,000 20% debentures and the balance in cash. The ordinary shares and the debentures were divided between the partners in their profit sharing ratio. Maina paid the dissolution expenses of the partnership out of his personal bank account in the amount of Sh. 90,000.
3. Interest on the debentures for the year ended 30 April 2001 has not been paid and has not accrued for either.
4. The company, which is called Maoja Limited, will pay a final dividend of Sh. 1 per shares on the profit made in the year. This had been decided at a meeting of the board of directors held on 30 April 2001.
5. Income tax at the rate of 30% on the adjusted profit for the year needs to be provided for in the amount of Sh. 470,000. No installment tax has been paid since the year under consideration is the first year in which the company operated.
6. Maoja Ltd. has a policy of amortising goodwill over five years on a straight line basis. In the year to 30 April 2001, turnover was Sh. 10,080,000, cost of sales was Sh. 6,720,000, distribution costs were Sh. 1,092,000 and administrative expenses were Sh. 588,000. Included in these expenses items were Directors' Remuneration of Sh. 60,000, staff costs of Sh. 402,000 (including contributions to a defined contribution plan of Sh. 21,000) included in administrative expenses, and depreciation included in distribution costs. Amortisation of goodwill should be included in administrative expenses

Required:

- (a). Prepare the Realisation and Capital Accounts of Maina and Ojaro to record the dissolution of the partnership. (7 marks)
- (b). Prepare for Maoja Limited the income statement for the year ended 30 April 2001 and the statement of financial position at that date in conformity with Kenya Companies Act and the International Accounting Standards. Do not prepare the statement of changes in equity – deal with dividends proposed and paid in the income statement. Ignore deferred tax. (13 marks)

CHECK YOUR ANSWERS WITH THOSE GIVEN IN THE LESSON 9 OF THE STUDY PACK

**COMPREHENSIVE ASSIGNMENT NO. 1
TO BE SUBMITTED AFTER LESSON 2**

To be carried out under examination conditions and sent to the Distance Learning Administrator for marking by the University.

TIME ALLOWED: THREE HOURS.

ANSWER ALL QUESTIONS

QUESTION ONE

Lock Stock and Barrel have been in partnership and contractors for many years. Owing to adverse trading conditions it has been decided to dissolve the partnership. Profits are shared as to lock 40%, Stock 30% and Barrel 30%. The partnership deed also provides that in the event of a partner being unable to pay off a debit balance, the remaining partners will treat this as a trading loss.

The partnership statement of financial position as at 1 January 2004 was as follows:

	Cost £	Depreciation £	NBV £
Non current assets			
Freehold land and buildings	20,000	3,000	17,000
Plant and equipment	150,000	82,000	68,000
Motor vehicles	<u>36,000</u>	<u>23,000</u>	<u>13,000</u>
	<u>206,000</u>	<u>108,000</u>	98,000
Current assets			
Inventory of land & buildings		75,000	
Houses in the course of construction		115,000	
Inventory of materials		23,000	
Debtors fro completed houses		<u>62,000</u>	
		275,000	
Current liabilities			
Trade payables	77,000		
Deposits and progress payments	82,000		
Bank overdraft	<u>132,000</u>	<u>(291,500)</u>	<u>(16,500)</u>
			<u>81,500</u>
Partners capital accounts			
Lock			52,000
Stock			26,000
Barrel			<u>2,500</u>
			<u>81,500</u>

During the six months from 1 January 2004 to the date of dissolution, the following transactions have taken place:

	£
Purchase of raw materials	20,250
Materials for houses in the course of construction	33,750
Payment for wages and subcontractors on building sites	78,000
Payments to trade payables for materials	45,000
Sales of completed houses	280,000
Cash received from customers for houses	225,000
Payments for various general expenses	12,500
Cash withdrawn by partners	

Lock	6,000
Stock	5,000
Barrel	4,000

All deposits and progress payments have been used for completed transactions.

Depreciation is normally provided for each year at £600 on the freehold yard and buildings, at 10% on cost for plant and equipment and 25% on cost for motor vehicles.

The partners decide to dissolve the partnership on 1 July 2004 and wish to take out the maximum cash possible, as items are sold. At this date, there are no houses in the course of construction and one third of the stock of land had been used for building.

It is agreed that Barrel is insolvent and cannot bring in any money in the partnership. The partners take over the partnership cars at an agreed figure of £2,000 each. All other vehicles were sold on 20 July 2004 for £6,200. At the same date, inventory of raw materials were sold for £7,000 and the stock of land realised £72,500. On 30 September 2004 the debtors paid in full and all the plant and equipment was sold for £50,000.

The freehold yard and buildings realised 100,000 on 1 November on which date all remaining cash was distributed.

Required:

- Prepare a partnership income statement for the six months to 1 July 2004, statement of financial positions at 1 July 2004 and the partners' capital accounts for the same period (8 marks).
- Show computations of the amounts distributable to the partners. (8 marks).
- Prepare a realisation account and the capital accounts of the partners to the final distribution. (4 marks).

QUESTION TWO

Grant and Herd are in partnership sharing profits and losses in the ratio 3 to 2. The following information relates to the year to 31 December 19-0;

	Dr. £000	Cr. £000
Capital accounts (at 1 January 19-0):		
Grant		300
Herd		100
Cash at Bank	5	
Accruals		25
Prepayments	18	
Drawings during the year:		
Grant (all at 30 th June 19-0)	40	
Herd (all at 31 March 19-0)	40	
Non current assets: at cost	300	
Accumulated depreciation (at 31 December 19-0)		100
Herd –salary	10	
Net profit (for the year to 31 December 19-0)		60
Inventory at cost (at 31 December 19-0)	90	
Trade payables		141
Trade receivables	223	
	<u>£ 726</u>	<u>£ 726</u>

Additional information

1. The partnership agreement allows for Herd to be paid a salary of £ 20,000 per annum, and for the interest of 5% per annum to be paid on the partner's capital account balances as 1 January in Each year, Interest at a rate of 10% per annum is charged on the partners drawings.
2. The partners decide to dissolve the partnership as at 31 December 19-0, and the business was then sold to Valley Limited. The purchase consideration was to be £400,000 1 Shares in Valley at a premium of 25 per share. The shares were to be issued to the partners on 31 December 19-0, and they were to be shared between them in their profit sharing ratio.

The sale agreement allowed Grant to take over one of the business car's at an agreed valuation of £10,000. Apart from the car and the cash at bank balances, the company took over all the other partnership assets and liabilities at their book values as at 31 December 19-0.

3. Matters relating to the appropriate of profit for the year to 31 December 19-0 are to be dealt with the partners capital accounts, including any arrears of salary owing to herd.

Required:

Write up the following accounts for the year to 31 December 19-0:

- i. **The profit and loss appropriate account;**
- ii) Grant and Herd's capital accounts;
- and
- iii) The realization account;

Prepare valley's statement of financial position as at 1 January 19-1 immediately after the acquisition of the partnership assuming that not no further transactions have taken place in the meantime.

QUESTION THREE

Drake and Stone carried on business in partnership under the firm name Drakestones and made up their accounts annually to 31 December. The relevant provisions in a partnership agreement were:

- a) Profits and losses should be shared in the proportion Drake three-fifths and Stone two fifths;
- b) Interest should be allowed on capital accounts at 5% per annum but no interest should be allowed or charged on current accounts;
- c) On the retirement or admission of a partner.
 - i) If the change takes place during any accounting year, such partner's share of profits or losses for the period up to retirement or from admission should be arrived at by apportionment on a time basis except where otherwise agreed;

- ii) No account for goodwill should be raised in the firm's books, any necessary adjustments as between continuing partners and retiring or incoming partners in respect of goodwill being made by transfers between the respective capital accounts,
- iii) Any balance due to an outgoing partner should carry interest at 4 % per annum from the date of his retirement to the date of payment.

By mutual agreement Stone retired from the partnership on 30 June 19x1, and on the following day an employee, Major, was admitted as a partner. It was agreed that the terms of the existing partnership agreement should apply in all respects except that, as from date, profits or losses should be shared in the proportion, Drake two-thirds and Major one-third.

A trial balance extracted from the books on 31 December 19x1 was as follows:

	Dr.	Cr.
	£	£
Purchases	36,200	
Inventory-1 January 19x1	6,400	
Wages	8,800	
Salaries	2,800	
Receivables	5,800	
Capital accounts-1 January 19x1		
Drake		5,000
Stone		3,000
Current accounts-1 January 19x1		
Drake		600
Stone		405
Sales		64,500
Drawings:		
Drake	1,200	
Stone	500	
Major	400	
Balance at Bank	7,205	
Trade expenses	640	
Furniture and fittings-1 January 19x1 at cost	2,400	
Furniture and fittings-provision for		
Depreciation to 1 January 19x1		620
Payables		4,600
Rent and rates	920	
Plant and machinery-1 January 19x1 at cost	6,200	
Plant and machinery-provision for		
Depreciation to 1 January 19X1		3400
Office expenses	1,370	
Bad debts	120	
Repairs	760	
Heating and lighting	410	
	<u>82,125</u>	<u>82,125</u>

No account has been taken in the books of a payment of £8,000 made on 1 July 19x1 to Stone by major, representing Major contribution of capital regarded as a payment to Stone on

account of the balance due to the latter on his retirement. The balance due to Stone after taking into account this payment remained unpaid at 31 December 19x1.

It was agreed that:

- 1) The inventory at 31 December 19x1 should be valued at £8,100.
- 2) The whole of the charge of £140 of the charge were specifically attributable to the period to 30 June 19x1.
- 3) The sum of £600 included in the total of salaries and paid to major prior to his being admitted as a partner should be entirely against the profits for the half year.
- 4) Plant and machinery should be depreciated at the rate of 10% per annum on cost, and fixtures and fittings at 5% per annum on cost;
- 5) At 31 December 19x1, wages accrued amounted to £120 and rates paid in advance to £40.
- 6) The firm's goodwill should be valued at June 19x1 at £21,000 but should not be retained in the accounts.

You are required to:

- a. Prepare the trading and profit loss account of the firm for the year to 31 December 19x1, and the statement of financial position as on that date, and
- b. Prepare partners capital accounts and current account (in columnar form) covering the year 19x1

QUESTION FOUR

The following list of account balances relate to Larcher, a public listed company, at 30 September 2003.

	\$'000'	\$'000'
Equity shares of \$1 each		100,000
11% Loan Note		30,000
Retained profit as at 1 October 2002		23,440
Property, plant and equipment at cost	216,740	
Depreciation of PPE as at 1 October 2002		50,740
Trade receivables	25,500	
Trade payables		8,390
Lease rental	800	
Sales		247,450
Cost of sales	165,050	
Distribution cost	13,400	
Administration expenses	12,300	
Income tax paid	400	
Interim dividends	3,300	
Loan interest paid	1,650	
Inventories as at 30 September 2003	16,240	
Cash at bank	<u>4,640</u>	
	<u>460,020</u>	<u>460,020</u>

The following notes are relevant.

- (a) Non current assets.

Property plant and equipment and its accumulated depreciation, is made up of the following assets.

	Cost \$'000'	Dep \$'000'
Land	12,000	Nil
Buildings	80,000	16,000
Plant	124,740	34,740

All of Larcher's land and buildings were revalued at open market value on 1 October 2002 at \$120 million in total. This was made up of \$20 million attributed to the land and \$100 million to the buildings. The buildings' original estimated life of 50 years (with a nil residual value) has not changed. From the date of the revaluation there were 40 years of life remaining. The directors wish to include the revalued amounts in the financial statements for the year to 30 September 2003. Plant is depreciated at 15% of the reduced balance.

(b) Lease rentals.

A lease rental of \$800,000 was paid on 30 September 2003. It is the first of five annual payments in arrears for the rental of an item of equipment that has cash purchase price of \$3 million. The auditors have advised that this is a finance lease and have computed the implicit interest rate as 10% per annum.

(c) Income tax.

A provision for income tax for the year ended 30 September 2003 of 9 million is required. Income tax is paid 6 months after the company's year end. A provision for income tax of \$6.8 million made for the year ended 30 September 2002 was settled on 31 March 2003 for \$7.2 million. A transfer of \$1.5 million is to be transferred to the deferred tax account.

(d) Sale or return basis.

Included in the trade receivables is an amount of \$7.65 million relating to sales made on a sale or return basis. The customer was meant to confirm acceptance but had not done so by the end of the year. Meanwhile the initial sales price had been marked down by 15% to encourage the customer to buy the goods. The company makes on average a profit of 20% on cost in relation to sales.

(e) The closing inventory given in the list of balances now seems to be incorrect because the stock take carried out on 30 September 2003 was not reliable. One week after the year end another stock take was carried out and this time the inventory was recorded at \$18 million. During the same week the firm made sales of \$2.1 million at normal selling price and Purchases of \$3.75 million.

(f) On 1 January 2002, Larcher agreed to act as a selling agent for an overseas company, Brandberg. The terms of the agency are that Larcher receives a commission of 10% on all sales made on behalf of Brandberg. This is achieved by Larcher remitting 90% of the cash received from Brandberg's customers one month after Larcher has collected it. Larcher has included in its sales revenue \$7.2 million of sales on behalf of Brandberg of which there is one month's outstanding balances of \$1.2 million included in Larcher's accounts receivable. The cash remitted to Brandberg during the year of \$5.4 million (i.e. 90% of \$6 million) in accordance with the terms of the agency, has been treated as the cost of the agency sales.

Required:

Prepare an income statement, statement of changes in equity and statement of financial position for the company according to the International Financial Reporting Standards for published purpose. (20 marks).

QUESTION FIVE

The following trial balance is prepared by Powis plc, plastics manufacturers on 31 May 2005 which is the end of the company's accounting period:

Powis plc		
Trial balance as at 31 May 2005		
	£	£
Share capital:		
Authorized and issued 300,000 ordinary shares of £1 each, fully paid		300,000
100,000 8.4% cumulative preference shares of £1 each, fully paid		100,000
Capital redemption reserve		50,000
Share premium account		100,000
General reserve		50,000
Retained profits – 31 May 2004		238,500
Goodwill	205,000	
Accumulated impairment – goodwill- 31 May 2005		39,500
Patents and trade marks	80,000	
Accumulated amortization – patents and trade marks – 31 May 2005		30,000
Freehold land and building at cost	250,000	
Leasehold property at cost	75,000	
Amortization of leasehold property – 31 May 2004		15,000
Factory, plant and machinery at cost	150,000	
Accumulated depreciation – plant and machinery – 31 May 2004		68,500
Fixtures and fittings	50,000	
Accumulated depreciation – fixtures and fittings – 31 May 2004		15,750
Motor vehicles at cost	75,000	
Accumulated depreciation – motor vehicles – 31 May 2004		25,000
10% Loan stock (2008-2009)		100,000
Accounts receivables and payables	177,630	97,500
Bank overdraft		51,250
Inventory – raw materials at cost – 31 May 2004	108,400	
Purchases – raw materials	750,600	
Carriage inwards – raw materials	10,500	
Manufacturing wages	250,000	
Manufacturing overheads	125,000	
Cash	5,120	
Work-in-progress – 31 May 2004	32,750	
Sales		1,526,750
Administration expenses	158,100	
Selling and distribution expenses	116,800	
Other expenses	54,100	
Provisions for doubtful debts – 31 May 2005		5,750
Inventory – finished goods – 31 May 2004	184,500	
	<u>2,858,500</u>	<u>2,858,500</u>

Additional information

	£	£
1. Inventory at 31 May 2005 was:		
Raw materials		112,600
Finished goods		275,350
Work-in-progress		37,800
2. Depreciation for the year to be charged as follows:		
Plant and machinery 8% on cost	- charged to production	
Fixtures and fittings 10% on cost	- charged to administration	
Motor vehicles 20% on reducing value	- selling and distribution	
3. Manufacturing overheads include:		
Works Director's salary		10,000
4. Administration expenses include:		
Executive director's salaries (three at £8,000 and one at £11,000)		35,000
Non-executive chairman's fee		2,500
5. Selling expenses include:		
Sales director's salary		13,000
6. Other expenses include:		
Auditor's fees		10,000
Auditors' expenses		500
Taxation service fees		1,250
Solicitor's fees for purchase of the freehold property Acquired 31 May 2005		5,000
7. Corporation tax at 30% on the profits of the year is estimated at £40,000 and is due for payment on 28 February 2006.		
8. The directors recommend that a dividend of 3.5 pence per share be paid on the ordinary share capital. No ordinary dividend was paid for the year ended 31 May 2005.		
9. The leasehold land and buildings are held on a 50-year lease, acquired ten years ago.		
10. Impairment and amortization has been charged on goodwill and intangible assets respectively (goodwill £14,000 and patents £4,000) and included under the relevant expense heading in the trial balance.		

Required

From the information given above and using the classification of expenses by nature, prepare the published accounts for the year ended 31 May 2005.

(20 marks)

Do not prepare a statement of changes in equity and the notes to the accounts.

END OF COMPREHENSIVE ASSIGNMENT No.1

NOW SEND YOUR ANSWERS TO DISTANCE LEARNING ADMINISTRATOR FOR MARKING.

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LESSON THREE

BRANCHES

OBJECTIVES

At the end of the lesson you should be able to:

- Deal with the accounting system whereby branch transactions are recorded in the Head office books;
- Deal with the maintenance of current accounts between the head office and branches where each branch maintains its own records, and the preparation of the overall Income statement and Statement of financial position for the enterprise as a whole;
- Account for transactions between a head office and a branch situated in a foreign country, and translate the foreign currency financial statements of a branch into the reporting currency of the Head Office in order to prepare the overall Income statement and Statement of financial position of the enterprise as a whole.

CONTENTS

- Read the study text below on:
 - a. System one: The head office maintains all accounts (selling agency branches);
 - b. System two: Each branch maintains full accounting records (autonomous branches);
 - c. Foreign branches.
- Attempt reinforcing questions at the end of the lesson and compare them with solutions given in Lesson 9.

INTRODUCTION:

Accounting has two main objectives:

- (i) To assist control over the assets and liabilities, and the income and expenditure of the enterprise; and
- (ii) To ascertain the profit or loss of the enterprise, the main sources of income and expenditure contributing to this profit or loss and the assets and liabilities that represent the profit or loss.

If the owners of an enterprise want it to earn more profit, they must increase the volume of turnover. As turnover increases, the enterprise must expand physically; as it expands, it will create departments, which deal with different lines of sales or services; there is a limit to the physical expansion at a single site – and the market there is also limited. Hence, enterprises set up branches, so that expansion can be continued. The need then arises to control the assets, liabilities, income and expenditure of the different departments and/or branches.

There are two main ways by which this can be achieved:

- (i) All the accounting records are maintained at the head office; or
- (ii) Each branch or department maintains its own accounting system.

There can be combinations of both systems; for example, each branch could maintain its own accounting system for income and expenditure, stock, debtors, cash and creditors, but fixed assets at branches, long-term investments made by and loans granted to the enterprise as a whole are reflected in the accounting system maintained by the head office.

We shall consider these accounting systems, and, in addition, we shall consider how accounts maintained by a foreign branch are translated into the currency of the head office.

1.1 SYSTEM ONE - THE HEAD OFFICE MAINTAINS ALL THE ACCOUNTS

This system is suitable for an enterprise that has small branches (possibly in another area of the town or city where the Head Office –HO – is situated), which sell goods supplied by the HO. On the sale of goods, cash is received which should be banked intact into the local branch of a bank; the bank can be instructed to credit the Head Office account, which is maintained at a different branch of the same bank. Cash expenditure by a branch is normally funded by an imp rest provided by the HO, replenished at regular intervals by a cheque for the actual amount of expenditure incurred. Where credit sales are permitted at a branch, each invoice raised at the branch will be made out in the triplicate; one copy is given to the customer as the invoice; the second copy is sent (as part of a batch of invoices) to the HO; the third is retained by the branch for reference. All goods should be purchased through a central buying department at the HO. Goods are issued to branches on the basis of requisitions received from branch managers. Of course it should be realized, that with the advent of computers the amount of paperwork may be substantially reduced and procedures not exactly as described.

The branch manager should be required to forward to HO at weekly, fortnightly or monthly intervals, returns giving particulars of goods received from and returned to HO, cash and credit sales, cash received from debtors, expenses, cash banked and stock and cash in hand at the end of the period. From these, the HO will maintain accounts for the branch in the HO books.

In order to provide a check that branch managers and staff deal properly with goods and cash passing through their hands, goods are normally charged to branches at the actual prices at which branches sell them. Consider the following set of figures relating to a branch:

20X2	Shs'000
January 1: Goods in hand at the branch, valued at selling price	3,000
January 31: Goods sent from the HO to the branch, valued at selling price	3,460
January 31: Goods sold to customers for cash in the month of January	3,280

What would be the value of closing stock at the branch at 31st January 20X2, valued at selling price?
It would be:

	Shs'000
Opening stock (at selling price)	3,000
Add goods received (at selling price)	<u>3,460</u>
Total goods available (at selling price)	6,460
Deduct goods sold (at selling price)	<u>3,280</u>
Closing stock (at selling price)	<u>3,180</u>

In the above example, it was assumed that there was no wastage of goods, no breakages, and no pilfering by customers, and that all sales were made at the predetermined selling price. A check can be made by staff from the HO, E.G from the internal audit department, to ensure that the stock of Shs 3,180,000 is really present at 31st 20X2. Usually an allowance will be made for wastage and breakages, e.g. if an allowance of 1% of goods sent to a Branch is given as a “normal loss”, a closing stock figure of Shs 3.18m – Shs 34,600 = Shs 3,145,400 would be accepted; if the stock level is less than this, an investigation as to why this is the case would be made.

1.2 In the HO books, the following accounts are kept in respect of each branch:

- a) Branch Stock Account
- b) Branch Mark-up (or Adjustment) Account
- c) Goods Sent To Branch Account
- d) Branch Total Debtors Account (if the branch is permitted to sell goods on credit) and
- e) Branch Expense Accounts

a) Branch Stock Account

- i. It is maintained at estimated selling price (invoice price).
- ii. It controls branch stocks.
- iii. The balance should represent the selling price of branch stock in hand.
- iv. Any difference between physical stock and the balance on the account must be investigated (unless this difference is a normal loss)

b) Branch Mark-up Account

- i. The opening balance represents the provision for unrealized profit on stock brought forward.
- ii. This account records anticipated profits on goods sent to branch.
- iii. The balance carried forward, representing unrealized profit on closing stock, is deducted from the branch stock account balance in the statement of financial position thus reducing stock to cost.
- iv. The gross profit of the branch will be the balancing figure in the account.

c) Goods Sent To Branch Account

- i. The amount on this account at the year-end represents the cost of goods sent to branch.

- ii. This figure is credited to the HO Trading account to reduce goods available for sale by head office (or if the head office is not a selling organization, the stocks held on behalf of the branches at the year end).
- iii. This account has neither an opening nor a closing balance.

d) Branch Total Debtors Account – This is used to control branch debtors.

- e) **Income statement** – The expenses incurred by each branch (posted to separate branch expense accounts) are charged against the branch gross profit to give the net profit or loss of the branch. These profit and loss accounts are normally prepared in a columnar format, so that the income statement for the enterprise as a whole can be arrived at. As the gross profit is shown in the mark up account, it is not necessary to prepare the trading account unless the examiner specifically requires this. In practice, however, the trading account is required so that the total turnover of the enterprise can be obtained.
- f) **Statement of financial position** – This is not normally required by the examiner under this system. However, if it is required, stock is shown at cost, which is arrived at by deducting the balance carried down on the mark up account from that on branch stock account.

Sundry Matters

- a. The accounting system is also appropriate for departmental accounts.
- b. The branch stock account is a practical means of controlling stock at the branch. Supervisors can quickly ascertain the selling price of stock at a branch and compare this with the balance shown in the head office books. Such spot checks will bring to light:
 - i. Normal differences e.g. wastage, evaporation, minor miscalculation of selling price, or errors in stock taking;
 - ii. Abnormal differences e.g. goods or cash stolen.
- c. This method prevents branch staff from knowing the cost of goods being sold and preserves secrecy with regard to profits.
- d. Ascertaining the percentage or fraction to deduct from invoice price may cause some students difficulty. No doubt it is appreciated that the percentage to be deducted from the selling price is not the same as that which is added to cost, e.g. If 33 1/3% is added to cost to arrive at invoice price then 25% must be deducted from selling price to get back to cost.

Mark up is defined as the rate of gross profit to cost of sales:

$$\text{Mark up} = \frac{\text{Gross Profit}}{\text{Cost of sales}}$$

Margin is defined as the rate of gross profit to sales:

$$\text{Margin} = \frac{\text{Gross profit}}{\text{Sales}}$$

Calculations of markup and margin are necessary to compute the profit loading on:

- Closing stock at the branch
- Returns from branch to head office

Examination questions may provide information on either the markup or the margin. If one is provided, it may be necessary to compute the other.

Let us assume:

$$\begin{array}{lcl} X & = & \text{Gross Profit} \\ Y & = & \text{Sales} \end{array}$$

Therefore:

$$\text{Margin} = \frac{\text{Gross Profit}}{\text{Sales}} = \frac{X}{Y}$$

However:

$$\text{Sales} - \text{Costs} = \text{Gross Profit}$$

Or:

$$\text{Costs} = \text{Sales} - \text{Gross Profit}$$

Which is stated as:

$$\text{Costs} = Y - X$$

And since:

$$\text{Mark up} = \frac{\text{Gross Profit}}{\text{Costs}}$$

This is stated as:

$$\text{Mark up} = \frac{X}{Y - X}$$

In summary, if:

$$\text{Margin} = P/Q$$

Then the related Markup shall be $P/(Q - P)$

Using similar arguments, it can be established that if the Markup is given by P/Q ,

Then the related margin shall be $P/(Q+P)$

For example, B Ltd marks up its goods by 2/11 of the cost. If the sales are Sh 202,800, what is the gross profit?

In conclusion, let us assume C Ltd earns a gross profit of 2/17 of its selling price. If the cost of sales in a particular month was Sh 4,819,500, what were the sales and gross profit?

$$\begin{array}{lclcl} \text{Gross Profit} & = & 2/15 \times 4,819,500 & = & 642,600 \\ \text{Sales} & = & (4,819,500 + 642,600) & = & 5,462,100 \\ \text{Sales} & = & (17/2 \times 642,600) & = & 5,462,100 \\ \text{Sales} & = & 17/15 \times (4,819,500) & = & 5,462,100 \end{array}$$

1.4 Double entry

Transactions	Debit	Credit
Cost of goods sent to branch	Branch stock account	Goods sent to branch account
Mark-up on goods sent to branch	Branch stock account	Branch mark up account
Cost of goods returned by branch to head office	Goods sent to branch account	Branch stock account
Mark-up on goods returned to head office	Branch mark-up account	Branch stock account
Cash sales	Cash account	Branch stock account
Credit sales	Branch debtors account	Branch stock account
Returns from credit customers	Branch stock account	Branch debtors account
Discounts allowed to credit customers	Branch profit and loss account	Branch debtors account
Bad debts written off	Branch profit and loss account	Branch debtors account
Amount of cash lost from branch	Branch profit and loss account	Branch stock account (or branch cash account)
Cost of stock lost from branch	Branch profit and loss account	Branch stock account
Mark-up on stock lost from branch	Branch mark-up account	Branch stock account
Amount of normal stock loss of branch	Branch mark-up account	Branch stock account
Balance on branch mark-up account being gross profit of branch	Branch mark-up account	Branch profit and loss account
Balance on goods sent to branch account being cost of goods sent for period	Goods sent to branch account	HO trading account

Illustration 1

A limited set up a branch in Buruburu, Nairobi, on 1st January 2002 to expand its volume of business. The accounts for the branch are maintained in the HO Ledger. Goods sent to the branch are invoiced to the branch at selling price, which is HO cost plus 33 1/3% of O cost.

By 31st December 2002, goods with a selling price of Shs 4m had been sent to the branch; goods with a selling price of Shs 200,000 were unsuitable for sale in this branch and were returned to the head office. In the year cash sales amounted to Shs. 2,800,000 and credit sales amounted to Shs 600,000 and closing stock on 31 December 2002 was (at selling price) Shs 400,000.

The Head Office and branch expenses are Shs 2,200,000 and Shs 810,000 for the year to 31 December 2002 respectively. For simplicity, these expenses have not been analyzed into their constituent components; they are posted in their total amounts in a columnar Expense Account.

BRANCH STOCK ACCOUNT

2002		Shs 000	2002		Shs 000
Dec 31	GSTB	3,000	Dec 31	Goods sent to branch	150
Dec 31	Branch Mark up	1,000	Dec 31	Branch mark-up	50
			Dec 31	Cash book	2,800
			Dec 31	Branch debtors	600
			Dec 31	Balance c/d	<u>400</u>
		<u>4,000</u>			<u>4,000</u>
2003					
Jan 1	Balance b/d	400			

BRANCH ADJUSTMENT (Mark up) ACCOUNT

2002		Shs 000	2002		Shs 000
Dec 31	Branch stock a/c	50	Dec 31	Branch stock a/c	1,000
Dec 31	Branch P & L	850			
Dec 31	Balance c/d	<u>100</u>			
		<u>1,000</u>			<u>1,000</u>
			2003		
			Jan 1	Balance b/d	1,000

GOODS SENT TO BRANCH ACCOUNT

2002		Shs 000	2002		Shs 000
Dec 31	Branch stock a/c	150	Dec 31	Branch stock	3,000
Dec 31	HO trading a/c	<u>2,850</u>			
		<u>3,000</u>			<u>3,000</u>

EXPENSE ACCOUNTS

2002		Shs 000	Shs 000	2002		Shs 000	
		HO	Branch	Dec 31		HO	Branch
Dec 31	Cash book/creditors	<u>2,200</u>	<u>810</u>	Dec 31	P&L a/cs	<u>2,200</u>	<u>810</u>

Let us see how the figures relating to this branch would now be combined with a set of figures for the HO to give an overall trading and Profit and Loss Account. The overall or combined sales figure would be shown in the statutory accounts of A Limited. We will assume that the following information relates to the head office:

	Shs 000
Opening stock at HO	1,000
Closing stock at HO	550
Purchases made by HO	10,500
Sales made by HO	10,800

TRADING & PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER

	2002		
	Head office	Branch	Combined
	Shs 000	Shs 000	Shs 000
Sales	<u>10,800</u>	<u>3,400</u>	<u>14,200</u>
Opening stock	1,000	NIL	1,000
Purchases/goods from HO	<u>10,500</u>	<u>2,850</u>	<u>10,500</u>
	11,500	2,850	11,500
	<u>(2,850)</u>		
Closing stock	8,650		
Cost of sales	<u>(550)</u>	<u>(300)</u>	<u>(850)</u>
Gross profit	<u>(8,100)</u>	<u>(2,550)</u>	<u>(10,650)</u>
Expenses	2,700	850	3,550
Net profit	<u>2,200</u>	<u>810</u>	<u>3,010</u>
Branch	500	<u>40</u>	<u>540</u>
Combined	<u>40</u>		
	<u>540</u>		

Even though the stocks and purchases in the branch are not accurate, let us assume that this is so until autonomous branches have been studied.

The branch sales, opening stock, goods from HO and closing stock figures are all memorandum figures i.e. these figures are extracted from the accounts in the ledger but they do not arise as a result of the double entry process.

In 2003, the following transactions occurred: we shall now call the Buru Buru branch of A Limited branch 1 (one) to distinguish it from branch 2, branch 3, etc.

	Shs 000
Goods sent to branch 1, at invoice price	6,000
Goods returned to HO from branch 1 at invoice price	180
Cash sales	4,800
Credit sales	1,020
Returns to branch 1 debtors	60
Returns to the HO by branch debtors	80
Goods sent to branch 2 from branch 1 (at selling price)	96
Goods sent to branch 1 from branch 3 (at selling price)	76
Branch 1 expenses for the year	1,100

We shall consider four different scenarios at 31st December 2003. In situation (a) when stock was counted on 31st December 2003, the value of the physical stock on hand valued at selling price agreed with the balance in the stock account.

In situation (b) when stock was counted on 31 December 2003, the value of physical stock on hand valued at selling price was Shs 360,000. After investigation, it was found that stock at selling value of Sh 80,000 had been stolen in the year.

In situation (c) again the closing stock was discovered to be short by Sh 80,000 (at selling price). In this case, it was established that cash was stolen on its way to the bank.

In situation (d), the closing stock was short by Shs 80,000 (at selling price). This figure is an acceptable normal loss amount due to evaporation, spilling, etc).

BRANCH 1 STOCK ACCOUNT

2003		a Shs 000	b, c, & d Shs 000	2003		Shs 000	Shs 000	Shs 000	Shs 000
Jan 1	Bal b/d	400	400	Dec 31	Sundry a/c	180	180	180	180
Dec 31	Sundry a/c Branch 1	6,000	6,000		CB	4,800	4,800	4,800	4,800
Dec 31	Debtors a/c	60	60	Dec 31	Branch 1 a/c	1,020	1,020	1,020	1,020
Dec 31	Branch 3 Stock a/c	76	76	Dec 31	Branch 2 Stock a/c	96	96	96	96
				Dec 31	Branch 1 mark up a/c	-	20	-	80
				Dec 31	Branch 1 P & L a/c	-	60	80	-
				Dec 31	Bal c/d	440	360	360	360
		<u>6,536</u>	<u>6,536</u>			<u>6,536</u>	<u>6,536</u>	<u>6,536</u>	<u>6,536</u>
2004									
Jan 1	Bal b/d	440	360						

BRANCH I MARK UP ACCOUNT

2003		a Shs 000	b Shs 000	c Shs 000	d Shs 000			a Shs 000	b,c,d Shs 000
Dec 31									
	Branch 1 stock a/c	45	45	45	45	Jan 1	Bal b/f	100	100
	Branch 1 debtors a/c	20	20	20	20	Dec 31	Branch 1 stock a/c	1,500	1,500
	Branch 2 markup a/c	24	24	24	24		Branch 3 markup ac	19	19
	Branch 1 stock a/c	-	20	-	80				
	Branch 1 P&L	1,420	1,420	1,440	1,360				
	Bal c/d	<u>110</u>	<u>90</u>	<u>90</u>	<u>90</u>				
		<u>1,619</u>	<u>1,619</u>	<u>1,619</u>	<u>1,619</u>			<u>1,619</u>	<u>1,619</u>
		<u>9</u>							
						2004			
						Jan 1	Bal b/d	440	

GOODS SENT TO BRANCH ACCOUNT

2003		Shs 000	2003		Shs 000
Dec 31	Branch 1 stock a/c	135	Dec 31	Branch 1 stock a/c	4,500
	Branch 1 debtors a/c	60	Dec 31	Goods sent to branch 3 a/c	57
	Goods sent to branch 2 a/c	72			
	HO trading a/c	<u>4,290</u>			
		<u>4,557</u>			<u>4,557</u>

COMPUTATION OF SALES

In situations (a), (b) and (d), Branch 1 sales for the year are arrived at as follows;

	Shs'000	Shs'000	Shs'000
Cash sales			4,800
Credit sales		1,020	
Deduct returns to: branch	60		
HO	<u>80</u>	<u>140</u>	<u>880</u>
Net sales			<u>5,680</u>

In situations (c), Branch 1 sales for the year are arrived at as follows;

	Shs'000
Cash sales as above	4,800
Add: cash collected but stolen before being banked	<u>80</u>
Total cash sales	4,880
Net credit sales, as above	<u>880</u>
Net sales	<u>5,760</u>

In d below it can be said that a normal loss is not reported separately in the Trading and Profit and Loss Account; since it is "normal", it is included as part of cost of sales and reduces the gross accordingly!

Branch 1 Trading & Income statement For The Year Ended 31 December 2003

		(a)	(b)	(c)	(d)
		No loss	Stock loss	Cash loss	Normal loss
		Shs '000'	Shs '000'	Sh '000'	Sh '000'
Sales	MEMO FIG	<u>5,680</u>	<u>5,680</u>	<u>5,760</u>	<u>5,680</u>
Opening stock	MEMO FIG	300	300	300	300
Goods received from HO	MEMO FIG	<u>4,290</u>	<u>4,290</u>	<u>4,290</u>	<u>4,290</u>
		4,590	4,590	4,590	4,590
Goods Stolen	MEMO FIG		<u>(60)</u>		
			4,530		
Closing stock	MEMO FIG	<u>(330)</u>	<u>(270)</u>	<u>(270)</u>	<u>(270)</u>
Cost of sales		<u>4,260</u>	<u>4,260</u>	<u>4,320</u>	<u>4,320</u>
Gross profit	DOUBLE ENTRY FIG	1,420	1,420	1,440	1,360
Expenses		(1,100)	(1,100)	(1,100)	(1,100)
Goods or cash stolen		—	<u>(60)</u>	<u>(80)</u>	—
Net profit		<u>320</u>	<u>260</u>	<u>260</u>	<u>260</u>

1.5 GOODS AT BRANCH MARKED DOWN, OR MARKED UP BY AN ADDITIONAL AMOUNT

If goods at the branch are not selling well, branch could be authorized by the Head office to mark down the goods. Conversely, if the goods are selling much better than expected, or if replacement goods will cost more, the selling price could be marked up. These mark-downs and mark-ups are credited or debited into the branch stock account and debited or credited into the branch mark-up account respectively.

Special care needs to be exercised in valuing closing stock.

Illustration 2

E Limited sent goods to its branch in Thika invoiced at selling price, which was cost plus 50% of cost. On 1st July 20X2, the opening stock in Thika was Shs 3 million at selling price. Goods at selling price of SHS 16.5 million were received by Thika in the year ended 30th June 20X3.

On 28th February 20X3, goods valued at selling price of Shs 6 million were marked-up by a further 40% of cost price. 75% of these goods were sold in the year ended 30th June 20X3. The remaining 25% were held in stock at 30th June 20X3. Sales for the year ended 30th June 20X3 amounted to Shs 16.8 million. Write up the Branch Stock and the Branch Mark-up accounts.

Branch Stock A/C					
20X2		Shs 000	20X3	Shs 000	
Jul 1	Balance b/f	3,000	Jun 30	Cashbook/debtors	16,800
20X3					
June 30	Sundry a/c	16,500			
Feb 28	Branch Markup a/c	<u>1,600</u>	Jun 30	Balance c/d	<u>4,300</u>
		<u>21,100</u>			<u>21,100</u>
20X3					
Jul 1	Balance b/d	4,300			

Branch Mark Up A/C					
20X3		Shs 000	20X2	Shs 000	
Jun 30	Branch profit and loss a/c	6,400	July 1	Bal b/f	1,000
			20X3		
Jun 30	Bal c/d	1,700	Jun 30	Branch stock a/c	5,500
		<u>8,100</u>	Feb 28	Branch stock	<u>1,600</u>
					<u>8,100</u>
			20X3		
			July 1	Balance b/d	1,700

Workings

a.

Sales	Selling price Sh '000'	Gross profit Sh '000'	Cost of sales Sh '000'
Total sales	16,800	6,400	10,400
Marked up goods (75% X Shs 7.6m)	5,700	2,700	3,000
Normal sales	11,100	3,700	7,400

b.

Closing stock

Total	4,300	1,700	2,600
Marked up goods	1,900	900	1,000
Normal sales	2,400	800	1,600

It can be seen that if goods are sold at a price in excess of the normal selling price, an additional profit is earned. Goods may be sold at a price in excess of the normal selling price without authority from the HO; if this occurs, the credit side of the branch stock account exceeds the debit side by the amount of the additional profits.

2 SYSTEM TWO – “AUTONOMOUS BRANCHES”**2.1 Legal Aspects**

There is no law relating to branch accounts but examination problems under this heading are frequently linked to either partnership or company account problems. Answering such problems will therefore requires knowledge of branch accounting as well as the legal matters appropriate to partnership or company accounting.

2.2 Accounts required and their purpose**a. Branch Current Account (Head Office Books)**

- Records all transactions branch and head office;
- The balance represents the investment made by head office in the branch.

b. Head office Current Account (Branch Books)

- Records all transactions between branch and head office;
- The balance represents the branch's capital;
- Income statement balance must be transferred to this account at the end of the period.

[**Tutorial note:** The branch current account in the head office books and the head office current account in branch books must be reconciled before preparation of final accounts.]

c. Final accounts

i. Examination questions – two types of problems arise in examinations:

Either (a) transfers between head office and branch are made at cost;

Or

(b) Transfers between head office and branch are made at “wholesale” price which will include a small element of profit. In such cases the examiner frequently requires the final columnar accounts to show in the branch column, goods from head office and stocks at invoiced price, but not reduce these the head office cost in the combined column.

- ii. Trading Account – head office column records transactions from the point of view of the head office. It show all purchase made by the head office, sales to customers and transfers to the branch at “wholesale” price.
- iii. Trading Account – branch column records transactions from the point of view of the branch. It shows goods received from head office at “wholesale” price and local purchases at cost, and stocks of goods from head office valued at “wholesale” price (i.e. includes an element of

unrealized profit from the point of view of the business as a whole) and stocks of local purchases valued at cost.

- iv. Trading Account – combined column records transaction from the point of view of the business as a whole, profits between head office and branch being eliminated – gross profit figures will not cross-cast to the combined gross profit.
- v. Income statement – provisions for unrealized profits on closing stock held by the branch on goods in transit are entered in the head office column. Net profit figures will cross cast to the combined net profit.
- vi. Statement of financial position – current accounts will appear in the head office and the branch columns but not in the combined column;
- vii. The provision for unrealized profit on branch stock and goods in transit will appear under current liabilities in the head office column but will be deducted from the stock figures in the combined column.
- viii. The ‘combined’ column in the income statement and in the statement of financial position are derived from the head office figures and the branch figures; normally the head office figures and the branch figures should be prepared first and the combined columns are then prepared from the individual columns.

2.3 Sundry Matters

- a. Current accounts balances must always be equal and opposite.
- b. The head office current account in the branch books should always have a credit balance.
- c. The branch current account in the head office books should always have a debit balance.
- d. Goods in transit and cash in transit must always be adjusted in the head office books (regardless of the direction in which they are in transit)
- e. The final entry to close the current account will be the transfer of branch profit to head office.

2.4 Double Entry

Transactions	IN HEAD OFFICE BOOKS	
	Debit	Credit
Invoice value of goods sent to branch (may be cost or “wholesale” price)	Branch current account	Goods sent to branch account
Cash received from branch	Cash account	Branch current account
Expenses of branch paid by head office (if any)	Branch current account	Cash account or expense creditors account
Profit of branch transferred into head office books	Branch current account	Profit and loss account
Provision for unrealized profit where goods are invoiced to branch at cost plus a mark up	Profit and loss account	Provision for unrealized profit account

- i. Adjustment for goods and cash in transit are always made on the credit side of the branch current account. The accounts will have equal and opposite balances once adjustments are made.
- ii. The balance on the current account is in fact represented by the branch fixed and current assets less liabilities (i.e. the head office has provided the branch with its capital).

Transactions	IN BRANCH BOOKS	
	Debit	Credit
Invoice value of goods received by branch (will not be the same as goods sent by head office if there are goods in transit)	Goods received from head office account	Head office current account
Cash sent to head office (will not be the same as cash received by head office if there is cash in transit)	Head office current account	Cash account
Expenses paid by head office on behalf of branch	Relevant expense account	Head office current account
Profit of branch transferred into head office books	Profit and loss account	Head office current

Pro-formstatement of financial positionfor a head office and autonomous branch:

	Head office		Branch		Combined	
	Sh	Sh	Sh	Sh	Sh	Sh
ASSETS						
Non – Current assets						
Property plant and equipment		X		X		X
Financial assets: investment in branch	X					
Less unearned profit	<u>(X)</u>					
		<u>X</u>		<u>-</u>		<u>-</u>
		X		X		X
Current assets						
Stocks in warehouses	X		X		X	
Stocks in transit	X					
Less unearned profit (UP)	<u>(X)</u>					
	X		-		X	
Debtors	X		X		X	
Cash at bank	X		X		X	
Cash in hand	X		X		X	
Cash in transit	X		-		X	
		<u>X</u>		X		X
		<u>XX</u>		<u>XX</u>		<u>XX</u>
EQUITY AND LIABILITIES						
Capital and Reserves						
Head office current account				X		
Ordinary share capital		X				X
P & L Reserve		<u>X</u>				<u>X</u>
		X				X
Non-current liabilities						
Bank loan		X				X
Current liabilities						
Creditors	X		X		X	
Accruals	<u>X</u>		<u>X</u>		<u>X</u>	
		<u>X</u>		X		X
		<u>XX</u>		<u>XX</u>		<u>XX</u>

Pro-form income statement for a head office and autonomous branch

	Head office		Branch		Combined	
	Sh	Sh	Sh	Sh	Sh	Sh
Sales		X		X		X
Goods sent to branch		<u>X</u>		<u>-</u>		<u>-</u>
		X		X		X
Cost of sales:						
Opening stock	X		X		X	
Purchases	X		-		X	
Goods from head office	<u>-</u>		<u>X</u>		<u>-</u>	
	X		X		X	
Less closing stock	<u>(X)</u>		<u>(X)</u>		<u>(X)</u>	
		<u>(X)</u>		<u>(X)</u>		<u>(X)</u>
Gross profit		X		X		X
Sundry expenses	X		X		X	
Increase in UP	X		<u>-</u>		<u>-</u>	
		<u>(X)</u>		<u>(X)</u>		<u>(X)</u>
Net profit		<u>XX</u>		<u>XX</u>		<u>XX</u>

Tackling the question

It is recommended that you reconcile the balances on the current accounts before working on the final accounts, which are most probably what the exam question will require. The positioning of current account balances in trial balances will be seen as follows:

Trial balance (extracts)

	Head office		Branch	
Head office current account	X		X	
Branch current account		X		X
	X		X	
		X		X
	<u>X</u>		<u>X</u>	
	<u>XX</u>		<u>XX</u>	

It is highly unlikely that the balances will be equal and opposite. The difference arises due to items in transit. What was sent out by the head office and recorded by them has not been fully received by the branch and reported. The difference may also arise when a branch sends items to the head office but the head office has not received everything dispatched by the branch. Therefore, each party has reported different values for transactions with each other, the difference being items in transit. Reconciliation of these accounts merely requires reporting items in transit in the branch current account in the books of the head office.

Illustration 3

The balances on the current accounts of a head office and branch were Ksh 698,000, before the transactions listed below:

	Kshs
Goods sent to branch by head office	1,727,000
Remittances received by head office from branch	892,000
Goods received by branch from head office	1,620,000
Remittances sent to head office by branch	944,000

Branch profit for the period	594,000
Goods in transit from head office to branch	107,000
Cash in transit from branch to head office	52,000

Books of head office:

Branch Current A/C			
	Sh		Sh
Bal b/d	698,000	Cash book	892,000
GSTB	<u>1,727,000</u>	Bal c/d	* <u>1,533,000</u>
	<u>2,425,000</u>		<u>2,425,000</u>
Bal b/d	1,533,000	Goods in transit	107,000
Branch profit	594,000	Cash in transit	52,000
	<u>2,127,000</u>	Bal c/d	<u>1,968,000</u>
			<u>2,127,000</u>

* Entry that is usually found in the trial balance of the Head Office.

Goods sent to branch			
	Sh		Sh
		Branch current a/c	1,727,000
Goods in transit			
	Sh		Sh
Branch current a/c	107,000		
Cash in transit			
	Sh		Sh
Branch current a/c	52,000		

Books of the branch:

Head office current account			
	Sh		Sh
Cash book	944,000	Bal b/d	698,000
Bal c/d*	<u>1,374,000</u>		<u>1,620,000</u>
	<u>2,318,000</u>		<u>2,318,000</u>
Bal c/d	<u>1,968,000</u>	Bal b/d	1,374,000
	<u>1,968,000</u>	Branch profit	594,000
			<u>1,968,000</u>

* Entry that is usually found in the trial balance of the branch.

Goods from head office			
	Sh		Sh
H.O current a/c	1,620,000		

Before commencing on final accounts, it is important to understand that each entity is deemed to be totally independent and standing alone in order to generate the financial statements as per the proforma statements seen earlier. This will be illustrate further:

Illustration 4

E Ltd sets up a branch in Nyeri on 1 July 2001. Goods are sent to branch at an invoice price which is 10% above cost. Sales attained during the financial year to 30th June 2002 were Sh 15m and sh 9m at the head office and branch respectively; goods sent to the branch had an invoice price of Sh 7.15m. Purchases by the head office totaled Sh 18m. What is the profit that the head office can claim to have made?

If the head office were to stand alone, it can claim two sets of sales:

	Sales to public		Goods sent to branch (deemed to be 'sales' to branch)	
	%	Sh'000	%	Sh'000
Cost	100	10,000	100	6,500
Profit	<u>50</u>	<u>5,000</u>	<u>10</u>	<u>650</u>
Selling price	<u>150</u>	<u>15,000</u>	<u>110</u>	<u>7,150</u>

Sales to public and goods sent to branch (currency columns only) can be combined to generate:

Cost	16,500
Profit	<u>5,650</u>
Selling Price	<u>22,150</u>

If the branch were to stand alone, it must consider its cost to be the value at which "goods were 'purchased' from the head office. This of course is the price at which the head office 'sold' the goods to the branch (110% of original cost to head office)

	%	Sh'000
Cost	110	6,600
Profit	<u>40</u>	<u>2,400</u>
Selling Price	<u>150</u>	<u>9,000</u>

All this information could be set out in the pro-forma layouts seen earlier as follows:

	Head office		Branch		Combined	
	Sh	Sh	Sh	Sh	Sh	Sh
Sales		15,000		9,000		X
Goods sent to branch		<u>7,150</u>		<u>-</u>		<u>-</u>
		22,150		9,000		X
Cost of sales: opening stock	-		-		-	
Purchases	18,000		-		X	
GFHO	=		<u>7,150</u>		<u>-</u>	
	18,000		7,150		X	
Closing stock	<u>(1,500)</u>		<u>(550)</u>		<u>(X)</u>	
		<u>(16,500)</u>		<u>(6,600)</u>		<u>(X)</u>
Gross profit		5,650		2,400		X

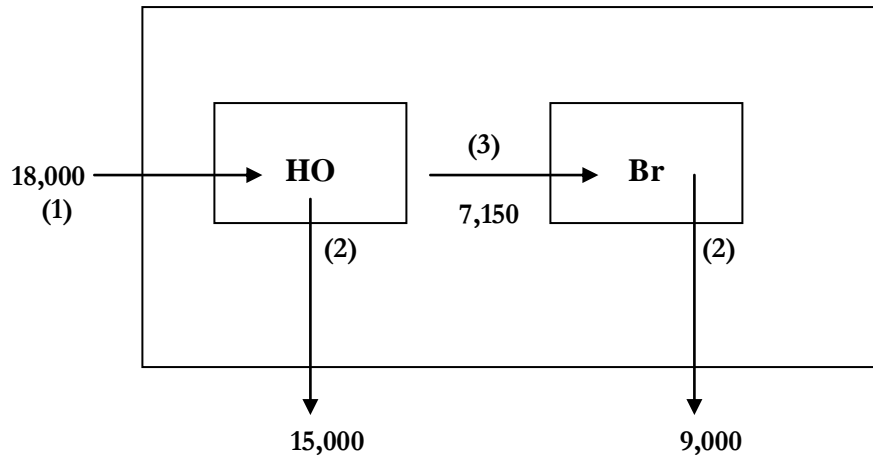
Tutorial note: Study the formats provided earlier in the chapter, then turn back to the income statement above. Try to understand how each item fits in. Remember, each item has a specific position where it belongs in the pro-forma layouts.

After arriving at a subtotal of opening stock, goods from head office and purchases, the following steps were applied:

- i. Slot in the gross profits based on the calculations made before commencement on the income statements (sh 5,650 in column 1 and Sh 2,400 in column 2)
- ii. Above this slot in / compute the cost of sales (Sh 16,500 in column 1 and Sh 6,600 in column 2)
- iii. The difference between the subtotal referred to above and the cost of sales will be the closing stock.

End of tutorial note.

The figures to appear in the combined income statement are based on the following diagram:

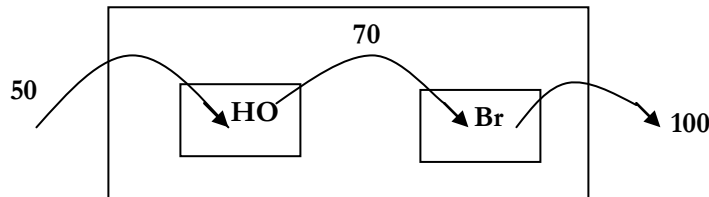


- An arrow pointing into a box refers to purchases by the organization represented by the box
- An arrow leading out of the box refers to sales made by the organization represented by the box
- The outside box refers to the combined entity.
- When the head office purchased and received goods costing sh 18,000, the combined entity also purchased and received goods costing Sh 18,000. Thus the purchases reported by the head office (column 1) will usually be the purchases reported by the combined entity (column 3). The only exception would be if the branch also had external purchases.
- If the head office and branch made sales of Sh 15,000 and Sh 9,000 respectively, the combined entity will have made sales of Sh 24,000 (Sh 15,000 + Sh 9,000)
- The sales of Sh 7,150 made by the head office (which is deemed to be a purchase by the branch) cannot be claimed to be a sale or purchase by the combined entity.
- The combined closing stock should be shown at original cost to the combined entity. This means that the combined closing stock is made up of two components, all at original cost:
 - (i) Closing stock at the head office at an original cost of Sh 1,500;
 - (ii) Closing stock at the branch. This had cost the branch Sh 550 (as can be seen in the income statements), but had an original cost of Sh 500 ($550 \times 100/110$) when received by the head office on behalf of the combined entity.

Complete trading accounts will be as follows:

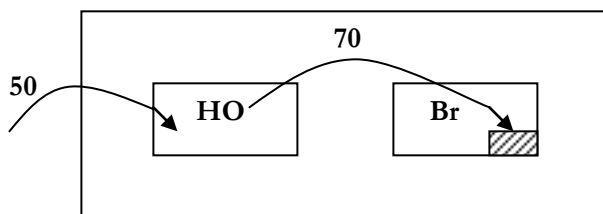
	Head office		Branch		Combined	
	Sh	Sh	Sh	Sh	Sh	Sh
Sales		15,000		9,000		24,000
Goods sent to branch		<u>7,150</u>		<u>-</u>		<u>-</u>
		22,150		9,000		24,000
Cost of sales:						
- Opening stock		-		-		-
- Purchases	18,000		-		18,000	
- Goods from head office	<u>-</u>		<u>7,150</u>		<u>-</u>	
	18,000		7,150		18,000	
Less closing stock	<u>(1,500)</u>		<u>(550)</u>		<u>(2,000)</u>	
		<u>(16,500)</u>		<u>(6,600)</u>		<u>(16,000)</u>
Gross profit		5,650		2,400		8,000

It can be seen that the combination of head office gross profit and branch gross profit do not give the combined gross profit. This is because, from a combined entity perspective, the profit made by the head office is deemed to be overstated. This is illustrated further below:



If the head office buys an item for Kshs.50, transfers it to the branch at Kshs.70, and the branch sells it off for Kshs.100, the head office made a profit of Kshs.20 (Kshs.70 - Kshs.50) and the branch made a profit of Kshs.30 (Kshs.100 - Kshs.70). This agrees with the combined profit of Kshs.50 (sales Kshs.100 – costs Kshs.50).

However, consider the following:



The head office buys an item for Kshs.50 and transfers it to the branch at Kshs.70. However the branch is unable to sell it and quotes it as closing stock for Kshs.70. The head office has reported a profit of Kshs.20; the branch reported no profit. The diagram clearly shows that the combined entity has no profit. At this point, a new concept comes to light:

The head office cannot claim to make any profit by just moving its stock to its branch – where the branch has not sold off the goods but is keeping them as closing stock.

The overstated profit reported by the head office needs to be eliminated. It is known as *unrealized profit*. In this example it is exactly equal to the overstatement in closing stock in the branch (difference between 'cost' to branch and original cost). The elimination of excess profit in the head office is accomplished by showing an expense *for the head office only*.

Illustration 5

A and B are partners in a business. A runs a head office in Mombasa and B runs a branch in Malindi. Separate books are maintained for the head office and the branch. Profits and losses are shared equally. The trial balances as at 30th June 2002 were as follows:

	Head Office		Branch	
	Sh	Sh	Sh	Sh
Property plant and equipment (NBV)	760,000		308,000	
Stocks at 1 July 2001:				
- Head office at cost	560,000			
- Branch at transfer price			340,000	
Goods sent to branch/from head office		1,430,800	1,398,800	
Debtors	348,960		78,080	
Sales		3,880,400		2,388,000
Bank and cash	612,280		115,360	
Purchases	3,918,000			
Remittances		2,247,600	2,257,200	
General expenses	680,000		400,000	
Branch current a/c/ Head office current a/c	2,530,640			2,498,640
Creditors		324,680		10,800
Capital at 1 July 2001 (held equally)		1,492,400		
Provision for unearned profit		<u>34,000</u>		
	<u>9,409,880</u>	<u>9,409,880</u>	<u>4,897,440</u>	<u>4,897,440</u>

Notes:

- Mombasa invoices goods to Malindi at cost plus one ninth
- At 30th June 2002:

- Stocks at head office at cost Sh 508,000
- Stocks at the branch at transfer price Sh 192,000
- Stocks in transit at transfer price Sh 32,000
- Cash in transit to head office Sh 9,600

Required:

- Prepare an incomes statement for the year ended 30th June 2002 and statement of financial position as at that date, separately for
 - The head office
 - The branch
 - The combined entity
- Post and balance both current accounts.

Tutorial note: As usual, it would be a better option to start with the current accounts as per the standardized procedure. It may not be possible to complete them, but items in transit may be posted to ensure that they have equal and opposite balances.

Branch current a/c			
	Sh		Sh
Bal b/d	2,530,640	Remittance	2,247,600
		Goods in transit	32,000
		Cash in transit	9,600
Head office current a/c			
	Sh		Sh
Remittance	2,257,200	Bal b/d	2,498,640

We know that the remittances had not been posted to the current accounts as yet because they are still hanging in the trial balance.

A and B

Income statement for the year ended 30th June 2002

	Head office		Branch		Combined	
	Sh	Sh	Sh	Sh	Sh	Sh
Sales		3,880,400		2,388,000		6,268,400
Goods sent to branch		<u>1,430,800</u>		-		-
		5,311,200		2,388,000		6,268,400
Cost of sales:						
– Opening stock	560,000		340,000		866,000	
– Purchases	3,918,000		-		3,918,000	
– GFHO	<u>-</u>		<u>1,398,800</u>		<u>-</u>	
	4,478,000		1,738,800		4,784,000	
Closing stock	<u>(508,000)</u>		<u>(192,000)</u>		<u>(709,600)</u>	
		<u>(3,970,000)</u>		<u>(1,546,800)</u>		<u>(4,074,400)</u>
Gross profit		1,341,200		841,200		2,194,000
Decrease in provision for UP		<u>11,600</u>		-		-
		1,352,800		841,200		2,194,000
General expenses		<u>(680,000)</u>		<u>(40,000)</u>		<u>(1,080,000)</u>
Net profit		<u>672,800</u>		<u>441,200</u>		1,114,000
Profit share: A					557,000	
B					<u>557,000</u>	
						<u>1,114,000</u>

The current accounts can now be properly completed:

Head office current account			
	Sh		Sh
Remittance	2,257,200	Bal b/d	2,498,640
<u>Bal c/d</u>	<u>682,640</u>	<u>Branch profit</u>	<u>441,200</u>
	<u>2,939,840</u>		<u>2,939,840</u>
		Bal b/d	682,640

Branch current a/c			
	Sh		Sh
Bal b/d	2,530,640	Remittance	2,247,600
Branch profit	441,200	Goods in transit	32,000
		Cash in transit	9,600
		Bal c/d	<u>682,640</u>
	<u>2,971,840</u>		<u>2,971,840</u>
Bal b/d	682,640		

A and B
Statement of financial position as at 30th June 2002

	Head office		Branch		Combined	
	Sh	Sh	Sh	Sh	Sh	Sh
ASSETS						
Non-Current Assets						
Property plant & equipment		760,000		308,000		1,068,000
Financial assets						
– Investment in branch	682,640					
– Less unearned profit	<u>(19,200)</u>					
		<u>663,440</u>				
		1,423,440		308,000		1,068,000
Current Assets						
Stocks in warehouses	508,000		192,000			680,800
Stocks in transit	32,000					
Less unearned profit	(3,200)					
	28,800					28,800
Debtors	348,960		<u>78,080</u>			<u>427,040</u>
Bank and cash in hand	612,280		115,360			727,640
Cash in transit	<u>2,600</u>		–			<u>2,600</u>
		<u>1,507,640</u>		<u>385,440</u>		<u>1,873,880</u>
		<u>2,931,080</u>		<u>693,440</u>		<u>2,941,880</u>
EQUITY AND LIABILITIES						
Head office current a/c				682,640		
Capitals: A		1,303,200				<u>1,303,200</u>
B		<u>1,303,200</u>				<u>1,303,200</u>
		2,606,400				<u>2,606,400</u>
Current liabilities						
Creditors		<u>324,680</u>		<u>10,800</u>		<u>335,480</u>
		<u>2,931,080</u>		<u>693,440</u>		<u>2,941,880</u>

Tutorial notes and workings:

	Sh		Sh
P & L (3)	11,600	Bal b/d (1)	34,000
Bal c/d (2)	<u>22,400</u>		
	<u>34,000</u>		<u>34,000</u>

The provision for unearned profit can now be described as a provision similar to provision for bad debts and provision for discounts allowed. When the amount of asset to be shown in the statement of financial position is overstated, it may be reduced by means of a relevant provision. This is what the provision for bad debts does to the overall value of debtors in the statement of financial position.

In this case the values of stocks that have been dispatched to the branch are above cost; i.e. values of stocks that have been dispatched to the branch are above cost, i.e. overstated, as can be seen in the computation for closing stocks:

	Sh	Sh
Stocks at head office		508,000
Stocks at branch at invoice price	192,000	
Less unearned profit	<u>(19,200)</u>	
		<u>172,800</u>
Stocks in warehouses (seen in statement of financial position)		680,800
Stocks in transit at invoice price	32,000	
Less unearned profit	<u>(3,200)</u>	
		<u>28,800</u>
Total stocks (seen in income statement)		<u>709,600</u>

The overstatement of stocks at the branch is reduced from the investment in branch (statement of financial position) Sh 19,200

The overstatement of stock in transit is reduced from the item itself (in the statement of financial position) Sh 3,200

Item (2) in the provision for unearned profit account Sh 22,400

Item (3) which is the increase or decrease in provision will finally be transferred to the income statement. It is the balancing figure in the provision account.

FOREIGN BRANCHES:

The head office may set up a branch in a foreign country. IAS 21 requires that the results of that foreign branch to be translated into the local currency for the purpose of preparing the financial statements for the whole business.

There are two main ways of translating the results of the branch ;

The functional currency method. (formerly temporal method)

Under this method, the branch is considered to be an extension of the head office and this is reflected by the trading arrangement between the head office and branch.

In most cases the head office will send goods to the branch and the branch will remit the proceeds on sale of these goods to the head office. Any exchange gain or loss arising from translating the results of the branch is treated as profit and loss item reported as an income or an expense.

Presentation method (formerly closing rate or net investment method)

Under this method, the branch operates with a lot of degree of autonomy from the head office. This position is reflected by the fact that there are fewer transactions taking place between the head office and the branch.

Any exchange gain or loss arising from translating the results of branch should be transferred to the foreign exchange reserve.

NOTE: the functional currency method is normally used because in most cases the branch is an extension of the head office and the presentation method should only be used if the examiner requires so.

The following should be the exchange rates to be used in translating the balances of the branch under each of the respective methods.

REF: Historical rate	: Rate when transaction took place (e.g. rate when asset was acquired)
Closing rate	: Rate on statement of financial position date (end of financial period)
Average rate	: Average rate of or the financial period.
Actual rate	: Actual rate on date of conversion of cash from the branch.
Specific rate	: Rate agreed by head office and branch for goods transferred from head

Balance	Functional currency Method	Presentation Method
Profit and loss items		
Sales	Average	Average
Opening inventory	Historical	Average
Purchases	Average	Average
Goods transferred from head office	Average/specific	Average/specific
Closing inventory – local purchases	Historical	Average
Goods from head office	Average/specific	Average/specific
Depreciation	Historical	Average
Office expenses	Average	average
Statement of financial position items		
Property, plant and equipment	Historical	Closing
Inventory – from local purchases	Historical	Closing
From head office	Specific	Specific
Receivables	Closing	Closing
Cash – at bank	Closing	Closing
- in transit	Actual	Actual
Payables	Closing	Closing
Head office current account – no translation but we take branch current account and deduct GIT and CIT		

The following steps should be followed in preparing the final accounts where we have a foreign branch.

- Update the trial balance of the branch that is given in the foreign currency with the following items:
 - closing inventory **DR Statement of financial position**
CR profit and loss.

b) Accrued or prepaid expenses. Accrual : **DR. profit and loss (expense)**
CR statement of financial position (liability)

Prepayment : **DR. Statement of financial position (Asset)**
CR Profit and loss (expense, income)

c) Depreciation: **DR. Profit and loss (expense)**
CR Statement of financial position (provision)

2 Translate the updated trial balance of the branch using the exchange rates given and depending on the method of translation.

Once the trial balance has been translated into the local currency, the debit side may not be the same as a credit side and balancing figure is the **exchange gain or loss**.

If the debit side is more than the credit side, then difference is an **exchange gain** and if the credit side is more than the debit side then the difference is an **exchange loss**.

3 Prepare the final accounts of the branch in the normal way using the trial balance of the head And the translated trial balance of the branch.

- Care should be taken on the treatment of the exchange gain or loss. The following points should be applicable.

a) If the functional currency method is being used, then any exchange gain or loss will appear in the column of the branch and the combined business in the profit and loss accounts. An exchange gain will appear as other incomes under gross profit and exchange loss and expense in the profit and loss account.

b) If the presentation method is being used, then the exchange gain or loss will be taken to a foreign exchange reserve which will appear as part of capital and reserves in the statement of financial position of the branch and the combined business or added to the head office current account.

EXAMPLE

K Ltd established a branch in Arusha Tanzania on 1.1.X2, when Kshs 1 = TShs 15. PPE costing Kshs 800,000 were purchased on that day. In addition, cash of Shs 500,000 was sent to Arusha on 1.1.X2, together with goods which had cost K Ltd Shs 1m. The Arusha branch sells HO goods and also goods purchased in Tanzania.

Arusha Branch Trial balance as at 31.12.X2

	Dr: TSH'000	Cr: TSH'000
PPE	12,000	
Sales		48,000
Goods from head office	15,000	
Purchases in Tanzania	15,000	
Expenses	18,000	
Receivables and Payables	2,000	1,000
Cash at bank	2,000	
Remittances to Kenya	19,500	
Head office current account		<u>34,500</u>
	<u>83,500</u>	<u>83,500</u>

Additional information:

- 1) Inventory at 31 December 20X2 was valued at Tsh 6 million, being goods from HO.
- 2) Depreciation is to be charged at 10% on the cost of fixed assets.
- 3) Accrued expenses amounted to Tsh 1.5 million.
- 4) Prepaid expenses amounted to Tsh 1.8 million.
- 5) There was no closing inventory of goods purchased in Tanzania.
- 6) The remittance was made on 1 Oct 2002 and translated into Ksh 1,650,000.
- 7) Exchange rates during the year were:

31 Dec X2:	Ksh 1 =	Tsh 10
1 Oct X2:	Ksh 1 =	Tsh 11.82 (Approx)
Average for the year	=	Ksh 1 = Tsh 12

Required:

Income statements for the year to 31 December X2 and statement of financial positions as at that date in

- i. Tanzanian shillings
- ii. Kenya shillings:
 - Using the functional currency method of translation;
 - Using the presentation method of translation.

[**Tutorial note:** All the relevant information in the notes to the trial balance will first be included in the trial balance. The adjusted trial balance can then be translated.]

Translation of Arusha branch trial balance (functional currency method)

	Original trial balance		Rate	Translated trial balance	
	Tsh'000	Tsh'000		Ksh'000	Ksh'000
PPE	12,000		1/15	800	
Sales		48,000	1/12		4,000
Goods from head office	15,000		1/15	1,000	
Purchases in Tanzania	15,000		1/12	1,250	
Expenses	17,700		1/12	1,475	
Receivables & Payables	2,000	1,000	1/10	200	100
Cash at bank	2,000		1/10	200	
Remittances to Kenya	19,500		ACT	1,650	
Head office current a/c		34,500	ACT		2,300
Closing inventory (for statement of financial position)	6,000		1/15	400	
Closing inventory (for trading a/c)		6,000	1/15		400
Depreciation expense (P&L)	1,200		1/15	80	
Provision for depreciation (statement of financial position)		1,200	1/15		80
Accrued expenses (statement of financial position)		1,500	1/10		150
Prepaid expenses (statement of financial position)	1,800		1/10	180	
	92,200	92,200		8,105	7,030

Exchange gain				7,235	205 7,235
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Translation of Arusha branch trial balance ((Presentation method)

	Original trial balance		Rate	Translated trial balance	
	Tsh'000	Tsh'000		Ksh'000	Ksh'000
PPE	12,000		1/10	1,200	
Sales		48,000	1/12		4,000
Goods from head office	15,000		1/12	1,250	
Purchases in Tanzania	15,000		1/12	1,250	
Expenses	17,700		1/12	1,475	
Receivables and Payables	2,000	1,000	1/10	200	100
Cash at bank	2,000		1/10	200	
Remittances to Kenya	19,500		ACT	1,650	
Head office current a/c		34,500	ACT		2,300
Closing inventory (for statement of financial position0	6,000		1/10	600	
Closing inventory (for trading a/c)		6,000	1/12		500
Depreciation expense (P&L)	1,200		1/12	100	
Provision for depreciation (statement of financial position)		1,200	1/10		120
Accrued expenses (statement of financial position)		1,500	1/10		150
Prepaid expenses (statement of financial position)	<u>1,800</u>	—	1/10	<u>180</u>	—
	<u>92,200</u>	<u>92,200</u>		8,105	7,170
Exchange gain				<u>8,105</u>	<u>935</u>
					<u>8,105</u>

Arusha Branch

Income statement for the year to 31 December X2 (functional currency method)

	Tsh'000	Tsh'000	Ksh'000	Ksh'000
Sales		48,000		4,000
Cost of sales:				
– Goods from head office	15,000		1,000	
– Purchases	<u>15,000</u>		<u>1,250</u>	
	30,000		2,250	
Less closing inventory	<u>(6,000)</u>		<u>(400)</u>	
		<u>(24,000)</u>		<u>(1,850)</u>
Gross profit		24,000		2,150
Exchange gain		=		<u>205</u>
		24,000		2,355
Expenses				
General expenses	17,700		1,475	
Depreciation	<u>1,200</u>		<u>80</u>	
		<u>(18,900)</u>		<u>(1,555)</u>
Net profit		<u>5,100</u>		<u>800</u>

Arusha Branch
Income statement for the year to 31 December X2 (Presentation method)

	Tsh'000	Tsh'000	Ksh'000	Ksh'000
Sales		48,000		4,000
Cost of sales:				
– Goods from head office	15,000		1,250	
– Purchases	<u>15,000</u>		<u>1,250</u>	
	30,000		2,500	
Less closing inventory	<u>(6,000)</u>		<u>(500)</u>	
		<u>(24,000)</u>		<u>(2,000)</u>
Gross profit		24,000		2,000
Expenses				
General expenses	17,700		1,475	
Depreciation	<u>1,200</u>		<u>100</u>	
		<u>(18,900)</u>		<u>(1,575)</u>
Net profit		<u>5,100</u>		<u>425</u>

Arusha Branch
Statement of financial position as at 31 December X2 (Functional method)

	Tsh'000	Tsh'000	Ksh'000	Ksh'000
ASSETS				
Non-current assets				
Property plant and equipment		10,800		720
Current Assets				
Inventory s	6,000		400	
Receivables	2,000		200	
Prepayments	1,800		180	
Bank	<u>2,000</u>		<u>200</u>	
		<u>11,800</u>		980
		<u>22,600</u>		<u>1,700</u>
CAPITAL AND LIABILITIES				
Head office current a/c		20,100		1,450
Current liabilities				
Payables	1,000		100	
Accruals	<u>1,500</u>		<u>150</u>	
		<u>2,500</u>		<u>250</u>
		<u>22,600</u>		<u>1,700</u>

Head Office Current A/C (In Branch Books): Functional currency method

	Tsh'000	Ksh'000		Tsh'000	Ksh'000
			GFHO	15,000	1,000
			Fixed Assets	12,000	800
Bal c/d	<u>34,500</u>	<u>2,300</u>	Cash	<u>7,500</u>	<u>500</u>
	<u>34,500</u>	<u>2,300</u>		<u>34,500</u>	<u>2,300</u>
Remittance	19,500	1,650	Bal b/d	34,500	2,300
Bal c/d	<u>20,100</u>	<u>1,450</u>	Branch profit	<u>5,100</u>	<u>800</u>
	<u>39,600</u>	<u>3,100</u>		<u>39,600</u>	<u>3,100</u>

Arusha Branch
Statement of financial position as at 31 December X2 (Presentation method)

	Tsh'000	Tsh'000	Ksh'000	Ksh'000
ASSETS				
Non-current assets				
Property plant and equipment		10,800		1,080
Current Assets				
Inventory	6,000		600	
Receivables	2,000		200	
Prepayments	1,800		180	
Bank	<u>2,000</u>		<u>200</u>	
		<u>11,800</u>		1,180
		<u>22,600</u>		<u>2,260</u>
EQUITY AND LIABILITIES				
Head office current a/c		20,100		2,010
Current liabilities				
Payables	1,000		100	
Accruals	<u>1,500</u>		<u>150</u>	
		<u>2,500</u>		<u>250</u>
		<u>22,600</u>		<u>2,260</u>

Head Office Current A/C (in branch books):

	Tsh'000	Ksh'000		Tsh'000	Ksh'000
			GFHO	15,000	1,000
			PPE	12,000	800
Bal c/d	<u>34,500</u>	<u>2,300</u>	Cash	<u>7,500</u>	<u>500</u>
	<u>34,500</u>	<u>2,300</u>		<u>34,500</u>	<u>2,300</u>
Remittance	19,500	1,650	Bal b/d	34,500	2,300
			Branch profit	<u>5,100</u>	<u>425</u>
Bal c/d	<u>20,100</u>	<u>2,010</u>	Exchange gain	-	<u>935</u>
	<u>39,600</u>	<u>3,660</u>		<u>39,600</u>	<u>3,660</u>

Example

On April 2001, Dolly Manufacturers Ltd opened a branch in Zumala, a foreign country whose currency is the zuma (zm), to sell an assortment of dolls. The branch manager was authorised to purchase local dolls for resale, but it was expected that the major proportion of the sales would be the dolls supplied by the head office in Kenya.

On 31 March 2002, the trial balance of the head office and branch were as follows;

	Trial balance as at 31 March 2002			
	Head Office		Branch	
	Ksh	Ksh	Ksh	Ksh
Share capital		50,000,000		
Reserves		20,000,000		
Profit and loss a/c		12,000,000		
Premises at cost	45,000,000			
Fixtures and fittings	16,000,000		94,500,000	
Provision for dep. fixtures & fittings		6,400,000		
Stock 1 April 2001	14,050,000			

Debtors	17,550,000		35,100,000	
Creditors		4,500,000		12,336,000
Bank balance	9,200,000		27,084,000	
Cash in hand	980,000		8,598,000	
Sales		101,090,000		277,233,000
Purchases	65,630,000		48,807,000	
Goods sent to branch		13,520,000		
Goods received from head office			156,500,000	
Branch current account	15,900,000			
Head office current account				129,350,000
Branch stock adjustment account		3,380,000		
Administration expenses	19,250,000		28,514,600	
Distribution expenses	<u>7,330,000</u>		<u>19,815,400</u>	
	210,890,000	210,890,000	418,919,000	418,919,000

Additional information

1. Stock on hand as at 31 March 2002 was;

Stock on hand as at 31 March 2002 was	
Head office	Ksh.28,500,000
Branch;	
From head office	Zm.12,000,000
From local purchases	Zm.9,775,000

2. Goods were invoiced by head office to branch at cost plus 23%. The branch sold the goods at invoiced price plus 50%. Goods sent to branch from head office were converted at affixed rate of 10 Zumas to 1 Ksh.
3. On 31 March 2002, goods in transit from head office to branch were at an invoiced value of Ksh.1,250,000
4. A remittance of Zm 5,800,000 from branch to head office was in transit on 31 March 2002. The remittance was converted at Zm.12.5 to Ksh.1
5. The fixtures and fittings were acquired when the exchange rate was Zm 10.5 to Ksh.1 on 1 July 2001.
6. Depreciation of the head office and branch fixtures and fittings is to be provided at the rate of 10% per annum on cost. A full year's depreciation should be provided branch fixtures and fittings.
7. The branch manager was to be allowed a commission of 2% on the sales of dolls supplied by the head office.
8. Rates of exchange at other dates were;
- 9.

	Zumus		Ksh.
1 June 2001	10	to	1
31 March 2002	12	to	1
Average for the year	11	to	1
Date of purchase of closing stock	11.5	to	1

Required

- (a). Trading, income statement in columnar form for the head office, the branch and the combined business for the year ended 31 March 2002. (12 marks)
- (b). Statement of financial position of the office, branch and the combined business as at 31 March 2002 (8 marks)

(Use the temporal method to translate branch balances into Kenya shillings)

Solution

Dolly Manufacturers
Trading, Profit and Loss account for the year ended 31 March 2002

	HEAD OFFICE	BRANCH	COMBINED	
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
	Sh. '000'			Sh. '000'
Sales to customers	101,090		25,203	126,293
Goods sent branch	<u>16,900</u>		<u>-</u>	<u>-</u>
	117,990		25,203	126,293
Cost of sales				
Opening inventory	14,050	-		14,050
Purchases	65,630	4,437		70,067
Goods from head office	<u>-</u>	<u>15,650</u>		<u>-</u>
	79,680	20,087		84,117
Closing inventory – in hand	(28,500)	(2,050)		(30,310)
- in transit	<u>-</u>	<u>51,180</u>	<u>18,037</u>	<u>(1,000)</u>
		66,810	7,166	73,486
GROSS PROFIT				
Expenses				
Provision for unrealized profit				
- inventory at branch	240	-		-
- goods in transit	250	-		-
Administration expenses	19,250	2,592		21,842
Distribution costs	7,330	1,801		9,131
Depreciation on furniture	1,600	900		2,500
Managers commission	-	394		394
Foreign exchange loss	<u>-</u>	<u>1,005</u>	<u>(6,692)</u>	<u>1,005</u>
NET PROFIT		<u>38,140</u>	<u>474</u>	<u>38,614</u>

Books of Head office

Branch current account			
	Sh. '000'		Sh. '000'
Balance b/d	15,900	Goodwill in transit	1,250
Branch profit	474	Cash in transit	464
	<u>16,374</u>	Balance c/d	<u>14,660</u>
			<u>16,374</u>

Head office current account			
	Sh. '000'		Sh. '000'
Balance c/d	14,660	Balance b/d	14,186
	<u>14,660</u>	Profit - branch	474
			<u>14,660</u>

Dolly manufacturers
Statement of financial position as at 31 March 2002

	HEAD OFFICE		BRANCH		COMBINED	
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
NON-CURRENT ASSETS						
Premises		45,000		-		45,000
Fixtures and fittings	16,000		9,000	8,100	25,000	
Depreciation on furniture	<u>(8,000)</u>	8,000	<u>(900)</u>		<u>(8,900)</u>	16,100
Branch current account	14,660		-	-	-	
Less U.P at branch	<u>(240)</u>	<u>14,420</u>	<u>-</u>	<u>8,100</u>	<u>-</u>	<u>-</u>
		67,420				61,100
CURRENT ASSETS						
Inventory – in hand	28,500		2,050		30,310	
- in transit	1,000		-		1,000	
Receivables	17,750		2,925		20,475	
Cash at bank	9,200		2,257		11,457	
In transit	464		-		464	
	<u>980</u>	<u>57,694</u>	<u>717</u>	<u>7,949</u>	<u>1,697</u>	<u>65,403</u>
In hand		125,114		16,049		126,503
Ordinary share capital		50,000		-		50,000
Reserves		20,000		-		20,000
Retained profits		50,614		-		50,614
Head office current a/c		<u>-</u>		<u>14,660</u>		<u>-</u>
Shareholders funds		120,614		14,660		120,614
CURRENT LIABILITIES						
Payables	4,500		1,028		5,528	
Manages commission	<u>-</u>	<u>4,500</u>	<u>361</u>	<u>1,389</u>	<u>361</u>	<u>5,889</u>
		<u>125,114</u>		<u>16,049</u>		<u>126,503</u>

Workings:

Managers commission	In z '000'
Goods from head office	156,500
Less closing inventory	<u>(12,000)</u>
Cost of sales for goods from head office	144,500
Add mark-up at 50%	72,250
Sales for goods from head office	216,750
Commission at 2%	4,335

Workings functional method

	Z '000'	Z '000'	E rate	Ksh. '000	Ksh. '000'
Fixtures and fittings – cost	94,500		X 1/10.5(H.R)	9,000	
Receivables	35,100		X 1/12 (C.R)	2,925	
Payables		12,336	X 1/12 (C.R)		1,028
Bank	27,084		X 1/12 (C.R)	2,257	
Cash in hand	8,598		X 1/12 (C.R)	717	
Sales		277,233	X 1/11 (A.R)		25,203
Purchases	48,807		X 1/11 (A.R)	4,437	
Goods from head office	156,500		X 1/10 (S.R)	15,650	
Head office current a/c		129,350	Branch C/A –G.I.T-C.I.T		14,186
Administration expenses	28,515		X 1/11 (A.R)	2,592	
Distribution expenses	19,815		X 1/11 (A.R)	1,801	
Closing inventory - B/s from Head office	12,000		X 1/10 (S.R)	1,200	
Local purchase	9,775		X 1/11.5 (H.R)	850	
Profit & loss from head office		12,000	X 1/10 (S.R)		1,200
Local purchase		9,775	X 1/11.5 (H.R)		850
Depreciation Profit & loss (expense)	9,450		X 1/10.5 (H.R)	900	
B/s –(provision for depreciation)		9,450	X 1/10.5 (H.R)		900
Managers commission - profit & loss (expense)	4,335		X 1/11 (C.R)	394	
B/s (accrual		4,335	X 1/12 (C.R)		361
Exchange loss (bal figure)	-	-		1,005	
	<u>454,479</u>	<u>454,479</u>		<u>43,728</u>	<u>43,728</u>

	Z '000'	Z '000'	E rate	Ksh. '000	Ksh. '000'
Fixtures and fittings – cost	94,500		X 1/10.5(C.R)	9,000	
Receivables	35,100		X 1/12 (C.R)	2,925	
Payables		12,336	X 1/12 (C.R)		1,028
Bank	27,084		X 1/12 (C.R)	2,257	
Cash in hand	8,598		X 1/12 (C.R)	717	
Sales		277,233	X 1/11 (A.R)		25,203
Purchases	48,807		X 1/11 (A.R)	4,437	
Goods from head office	156,500		X 1/10 (S.R)	15,650	
Head office current a/c		129,350	Branch C/A –G.I.T-C.I.T		14,186
Administration expenses	28,515		X 1/11 (A.R)	2,592	
Distribution expenses	19,815		X 1/11 (A.R)	1,801	
Closing inventory - B/s from Head office	12,000		X 1/10 (S.R)	1,200	

Local purchase	9,775		X 1/12 (C.R)	850	
Profit & loss from head office		12,000	X 1/10 (S.R)		1,200
Local purchase		9,775	X 1/11 (A.R)		889
Depreciation Profit & loss (expense)	9,450		X 1/11 (A.R)	900	
B/s –(provision for depreciation)		9,450	X 1/12 (C.R)		788
Managers commission - profit & loss (expense)	4,335		X 1/11 (A.R)	394	
B/s (accrual		4,335	X 1/12 (C.R)		361
Exchange loss (bal figure)	-	-		<u>2,133</u>	
				<u>43,655</u>	<u>43,655</u>

Under presentation method, the final accounts will be prepared the same way as before. However, the exchange loss of sh.2,133 will appear as a negative reserve in the statement of financial position of the branch and the combined business.

REINFORCEMENT QUESTIONS

QUESTION ONE

B LTD, whose head office is in Mombasa, operates a branch at Malindi. All goods are purchased by head office and invoiced to and sold by the branch at cost plus $33\frac{1}{3}\%$. Other than a sales ledger kept in Malindi, all transactions are recorded in the books in Mombasa. The following particulars are given of the transactions at the branch during the year ended 30th June 20X7.

	Shs
Stock on hand, 1 st July 20X6 at invoice price	308,000
Debtors on 1 st July 20X6	276,220
Stock on hand, 30 th June 20X7 at invoice price	276,360
Goods sent from Mombasa during the year at invoice price	1,736,000
Credit sales	1,470,000
Cash sales	168,000
Returns to head office at invoice price	70,000
Invoice value of goods stolen	42,000
Bad debts written off	10,360
Cash from debtors	1,568,000
Normal loss at invoice price due to wastage	7,000
Cash discount allowed to debtors	29,960

Any further loss should be treated as a loss of cash.

You are required to write up the Branch Stock Account, the Branch Mark-up Account and Branch Total Debtors Account for the year ended 30th June 20X7 as they would appear in the head office books.

(Total: 15 marks)

QUESTION TWO

DLimited has a head office in Nairobi and a branch in Bungoma. The following information has been extracted from the head office books of account as at 31st March 20X6.

Information relating to the branch

	Opening Shs'000	Closing Shs'000
Balances		
Branch bank account (positive balance)	30	120
Branch debtors	660	810
Branch stock (at transfer price)	750	900
<i>Transactions during the year</i>		Shs'000
Bad debts written off		150
Branch general expenses (paid from bank branch account)		420
Cash received from credit customers and banked		3,900
Cash sale banked		1,200
Cash transferred from branch to head office bank account		4,590
Credit sales		4,370
Discounts allowed to credit customers		90
Goods returned by credit customers		80
Goods returned from branch (at transfer price from head office)		300
Goods sent to branch (at transfer price from head office)		6,000

INFORMATION RELATING TO HEAD OFFICE

Balances

	Opening Shs'000	Closing Shs'000
Stock	1,800	2,200
Transaction during the year	Shs'000	
Bad debts written off	240	
Cash sales	15,000	
Credit sales	20,000	
Discounts allowed to credit customer	290	
General expenses	4,100	
Goods returned by credit customers	400	
Purchases	27,800	

Additional information:

1. Most of the accounting records relating to the branch are kept by the head office in its own books of account.
2. All purchases are made by the head office, and goods are invoiced to the branch at selling price, that is, at cost plus 50%.

Required:

- a. Write up the following ledger accounts for the year to 31st March 20X6, being careful to bring down any balances as at that date:
 1. Branch stock account;
 2. Goods sent to branch account;
 3. Branch stock adjustment account;
 4. Branch debtors account; and
 5. Branch bank account.
- b. Compile D Limited's Income statement for the year to 31st March 20X6 showing the turnover, gross profit and net profit for the head office, the branch and the enterprise as a whole.
- c. Examine briefly the merits and demerits of D Limited's method of branch bookkeeping including comments on the significance of the 'balance figure' in the branch stock account.

QUESTION THREE

The following balances were extracted from the books of K Limited which has a head office in Nairobi and a branch in Nakuru.

	NAIROBI (Head office)		NAKURU (BRANCH)	
	Dr Shs 000	Cr Shs 000	Dr Shs 000	Cr Shs 000
Issued share capital (35,000 ordinary shares of Shs 20 each)		700,000		
Unclaimed commission		5,000		
Profit and loss account		150,000		
General reserve		100,000		
Current accounts (1 st June, 20X1)	124,000			124,000
Goods from Nairobi to Nakuru (at cost)	350,000			350,000
Purchases	1,050,000		660,000	
Sales		1,360,000		860,000
Stock (1 st June 20X1)	260,000		90,000	
Remittances from Nakuru		550,000	600,000	
Sundry debtors and creditors	170,000	47,000	6,000	48,000
Furniture and fittings	280,000		50,000	
Rent and rates	10,000		14,000	
Salaries and wages	130,000		80,000	
Staff commission paid	8,000		6,000	
Water and electricity	28,000		15,000	
Advertising	13,000		2,000	
Sundry expenses	18,000		5,000	
Motor vehicles	155,000		35,000	
Cash at bank	<u>216,000</u>			<u>174,500</u>
	<u>2,912,000</u>	<u>2,912,000</u>	<u>1,563,000</u>	<u>1,563,000</u>

The following information is also available:

- i. The staff of K Limited are entitled to a commission equal to 12% of the net profit before charging directors' fees, provision for doubtful debts and such commission.
- ii. Depreciate furniture and fittings at 12 ½% per annum and motor vehicles at 25% per annum
- iii. Provide a dividend of 20 % on the issued capital.
- iv. Directors' fees payable by the head office amounted to Shs 35,000.
- v. Make a provision for doubtful debts of 5% on the sundry debtors.
- vi. Transfer Shs 40,000 to the general reserve.
- vii. The branch purchases include goods transferred from head office
- viii. Closing stock, Nairobi Head office – Shs 320,000, Nakuru branch – Shs 85,000.

Required:

Prepare the Trading and Profit and Loss Accounts in columnar form, the Appropriation Account, for the year ended 31st May, 20X2 and the statement of financial position as at that date, for the Head office, the Branch and the overall company.

(Total: 25 marks)

QUESTION FOUR

Maina commenced business on 1st January 20X9 at a head office and at one branch. Purchases were made exclusively by head office where all goods were processed before sale. There was no loss nor wastage in the processing. Only processed goods received from head office were handled by the branch and these were charged thereto at processed cost plus 10%. All sales whether by head office or the branch were at a uniform gross profit of 25% on the processed cost.

The following trial balances as on 31st December 20X9 were extracted from the books before adjusting for any of the matters referred to below:

	Head office		Branch	
	Shs 000	Shs 000	Shs 000	Shs 000
Maina – capital		15,500		
Drawings	2,750			
Purchases	98,475			
Cost of processing	2,525			
Sales		64,000		41,000
Goods sent to/received by branch		46,200	44,000	
Selling and general expenses	9,450		1,060	
Debtors/creditors	15,480	30,070	5,680	540
Head office/branch				
Current account	19,490			13,075
Balance at bank	<u>7,600</u>		<u>3,875</u>	
	<u>155,770</u>	<u>155,770</u>	<u>54,615</u>	<u>54,615</u>

You ascertain that:

1. Goods charged by head office to the branch in December 20X9, at Shs. 2.2m were not received or recorded by the branch until January 20X0, and a remittance of shs 4.215m from the branch to head office in December 20X9 was not received or recorded at head office until January 20X0. Any necessary adjustments in respect of these items are to be made in the head office accounts.
2. Stock taking at the branch disclosed a shortage of goods of a selling value of Shs 1m. There was no shortage or surplus at head office.
3. The cost of the stock of unprocessed goods at head office on 31st December 20X9 was Shs 5m.

For the purpose of the separate trading account of the head office, stocks are valued at cost. In the case of the separate account of the branch, stocks are to be valued at the price charged by head office. Any necessary adjustments are to be made in the head office profit and loss account.

You are required to prepare in columnar form for:

i. The head office ii. The branch and iii. The business as a whole:

- a. Trading and Profit and loss accounts for the year ended 31st December 20X9 and,
- b. Statement of financial positions as on that date. (Ignore taxation)

(Total: 24 marks)

QUESTION FIVE

Antiquarius Ltd is a company which deals in antiques. The Company is based in London and operates in the UK, but also has a profitable outlet in San Francisco, California, which is managed by one of the directors on his frequent trips to the States. Separate records are kept of the outlet's transactions by the American staff.

The following trial balances were extracted from the books of Antiquarius Ltd at 31 December 2003

	London		San Francisco	
	£	£	\$	\$
Share capital		20,000		
Retained Profits as at 1 January 2003		20,200		
Lease hold premises	15,000		40,000	
Amortization of lease		7,000		8,000
Delivery vans, at cost	12,000		10,000	
Provision for dep'n on delivery vans		6,000		5,000
Opening inventory, at cost	8,620		12,460	
Accounts receivable	3,869		6,293	
San Francisco current account	22,600			
London current account				44,400
Sales		78,318		116,308
Transfers to San Francisco		21,600		
Purchases	70,066		21,800	
Transfers from London			38,620	
Administration expenses	2,386		3,142	
Salaries and wages	17,420		23,500	
Selling and delivery costs	5,485		8,940	
Provision for unrealized profit		500		
Cash at bank	6,923		13,879	
Accounts payable		10,751		4,926
	<u>164,369</u>	<u>164,369</u>	<u>178,634</u>	<u>178,634</u>

You are given the following additional information:

- Transfers of goods from London to San Francisco are made at cost plus 20%.
- The average rate of exchange during the year was \$1.80 to the £. The rates of exchange at 1 January 2003 and 31 December 2003 were \$2.00 and \$1.60 to the £ respectively.
- Inventory of antiques on hand at 31 December 2003 were:

London	£ 12,470
San Francisco (including \$9,180 of goods sent from London when the rate of exchange was \$1.70)	\$15,240

- Salaries and wages for London include director's emoluments of £8,000 of which £3,200 is to be charged to the US outlet at the rate of exchange of \$1.60 to the £1.
- Administration expenses accrued but not yet taken into account amount to:

London	£800
San Francisco	\$760
- When the leasehold premises and delivery vans were acquired in San Francisco the rate of exchange was \$2.20 to the £.
- Depreciation is to be provided for the year on the vans at 25% of cost, and the leases are to be amortized by equal amounts written off over the periods of the leases, which are:

- | | |
|---------------|----------|
| London | 15 years |
| San Francisco | 10 years |
- (h) On 31 December 2003 London office had shipped a regency bureau to San Francisco at a value of £900. Although they recorded as a transfer in the London books no entry was made in the books in San Francisco until it was received on 20 January 2004.

You are required to prepare for the year ended 31 December 2003

- (a) The trial balance of the San Francisco outlet, converted at 'historic rate', after making the year end adjustments, and indicating clearly the rates of the conversion used. (3 marks)
- (b) The income statement of London, San Francisco and the combined business in columnar form. (10 marks)
- (c) The statement of financial position of the combined business (7 marks)
- (Total: 20 marks)**

END OF REINFORCING QUESTIONS

NOW CHECK YOUR ANSWERS WITH THOSE GIVEN IN LESSON 9 OF THE STUDY PACK

LESSON FOUR

GROUP ACCOUNTS

OBJECTIVES

After studying this lesson you should:

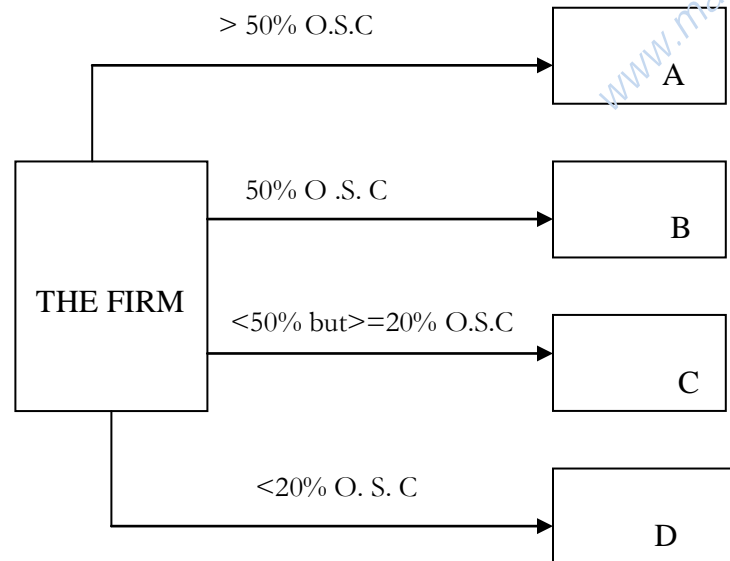
- Understand why group accounts are prepared;
- Know the Companies Act and the international Accounting Standards requirements in relation to the preparation of group accounts;
- Know how to prepare the consolidated Statement of financial position of a group of companies,
- Know how to prepare the consolidated Income statement of a group of companies,
- Know how to prepare the consolidated cash flow statement and the treatment of Associate companies in group accounts.

CONTENTS

- Read the Study Text below.
- Attempt the reinforcing questions at the end of the Lesson.
- Compare your solutions with those given in Lesson 9.

4.1 INTRODUCTION:

A company can have investments in other companies in the form of : ordinary shares, preference shares and loan stock. The investment in ordinary shares leads to ownership and therefore requires further consideration. The investment in the ordinary shares can be summarized diagrammatically as follows;



NOTE;

1. Company A is referred to as a subsidiary company and is accounted as per the requirements of 1AS 27 “ subsidiary company and separate financial statements.”
2. Company B is a **jointly controlled entity** and is accounted for according to the requirements of 1AS 31 “joint ventures”.
3. Company C is an **Associate company** and is **accounted** for as per requirements of 1AS/28 “Associate companies”.
4. Company D is a **pure investment** accounted for as per requirements of 1AS 32 and 39 “financial instruments.
Jointly controlled entities and pure investments are beyond scope.

SUBSIDIARY COMPANIES (1AS 27)

A subsidiary company is a company in which the investing company (also called holding or parent company) controls the financial and operating policies of the subsidiary company.

In most cases, control is evidenced (but not limited) to owning more than 50% of the ordinary share capital of the subsidiary company. Control may also be exercised in the following ways;

- i) The holding company owing more than 50% or the voting rights in the company or subsidiary company.

- ii) The holding company being able to appoint majority of the directors in the board of directors.
- iii) The holding company carrying out favourable transactions with the subsidiary e.g. sale and purchase of goods at a price below the market value.

The substance of the relationship between holding company and subsidiary company is the effectively, the holding company controls the subsidiary company. This means that the holding company control the assets of the subsidiary company and is liable to the debts of the subsidiary company.

1AS 27 therefore requires that the holding a company should include the financial results of the subsidiary company in its own financial statements. The process involves adding the assets, liabilities and incomes and expenses of the subsidiary company to those of the holding company while excluding inter-company transactions and balances. This process is called **consolidation** and the combined financial statements are called **Group accounts or consolidated accounts**.

1AS 27/IAS 1 require the holding company to present the following in its published financial statements.

- i) A consolidated income statements
- ii) A consolidated statement of changes in equity
- iii) A consolidated statement of financial position
- iv) A consolidated cash flow accounts
- v) Group notes to the accounts.

1AS 27 also requires the holding company to present its own financial statements separately ie excluding the subsidiary company.

1 CONSOLIDATED STATEMENT OF FINANCIAL POSITION

The consolidated statement of financial position involves adding assets and liabilities of the subsidiary to those of the holding company while excluding inter-company balances. The following points need to be considered in preparing the consolidate statement of financial positions.

i) Good will on consolidation

Good will on consolidation arises when the purchase consideration paid by the holding company is different from the value of the net assets acquired in the subsidiary company.

If purchase consideration is more than net assets acquired, then the difference is positive goodwill and if purchase considered is less than net assets acquired, then the difference is negative goodwill.

Goodwill will thus be computed in the following two ways;

Method 1

Cost of investment in subsidiary	£	£
less:		xx
Ordinary share capital of subsidiary	x	
Capital reserves or date of acquisition	x	
Revenue reserves (retained profits) on date of acquisition	x	
Shareholders funds on date of acquisition	xx	
Holding company shares acquired		(x)
GOODWILL POSITIVE/NEGATIVE		<u>xx</u>

Method 2

Cost of investment in subsidiary	£
Less: share of net assets acquired (on date of acquisition)	xx (x) xx/(xx)

NOTE : Total assets less total liabilities i.e. net assets is the same as shareholders funds. The most common approach used in computing goodwill is by preparing an account called **cost of control** whereby the cost of investment is posted on the debit side and the holding company share of the ordinary share capital, capital reserves and revenue reserves on the date of acquisition in the subsidiary company are posted on the credit side. The balancing figure in that account is goodwill.

ii) Minority interest (MI)

When the holding company owns less than 100% of the ordinary share capital of the subsidiary company then the other balance is held by minority interest. Therefore if the holding company owns 80% of the ordinary share capital of the subsidiary then the minority interest owns 20%. The minority interest (M.I) should be shown separately in the consolidated statement of financial position but as part of shareholders funds and the figure to appear in the statement of financial position will be made up of the following.

- Minority interest share of the ordinary share capital in subsidiary on statement of financial position date
- Minority interest share of capital reserves in subsidiary company on statement of financial position date
- Minority interest share of revenue (retained profits) in subsidiary company on statement of financial position date.

Alternatively, the total due to the minority interest can be prepared by opening the Minority Interest account whereby the Minority interests share of the osc, capital reserves and retained profits in subsidiary company is **posted** to the credit side.

iii) Group retained profits

Retained profits ideally should be the amounts that can be distributed as dividends. Therefore, in arriving at group retained profits, careful attention should be paid to the profits of the subsidiary company. All the profits of the holding company can be distributed or are distributable.

However, the subsidiaries profits belong to both the holding company and the minority interest. Thus the share that belongs to the minority interest will be transferred to the Minority interest's account.

The remaining profits that belong to the holding company should be split between pre-acquisition profits and post acquisition profits.

The **pre acquisition profits** are the profits in the subsidiary company on the date of acquisition and are thus used in computing goodwill.

The **post acquisition profits** relate to the period after acquisition and can thus be distributed or can be paid out to the shareholders of the holding company. They should thus form part of the group retained profits.

In summary, the group-retained profits is made up of: -

Holding company's retained profits	£
Add: Holding company's share of post acquisition retained profits In subsidiary company	x
	x
	xx

iv) Preference share capital in subsidiary (irredeemable)

Investment in preference shares does not lead to ownership and therefore, if the holding company owns part of the preference share capital in subsidiary company then, the percentage will not be the basis of consolidation.

However, the asset of investment in preference shares and the percentage of preference shares acquired will still be used to compute goodwill arising on consolidation.

The other statement of financial position is due to the minority interest and will thus be included as part of total due to minority interest or posted to credit side of minority interest account.

vi) Loan stock in subsidiary

The holding company may also invest in the loan stock of the subsidiary company or part of the loan stock of the subsidiary company. The cost of the loan stock to the holding company will not be used to compute goodwill but instead should cancel out with the liability appearing in the subsidiary company such that in the consolidated statement of financial position, only the loan stock held by 3rd parties in the group will appear.

Group loan stock will thus be given as follows: -

Loan stock appearing holding company statement of financial position	£	£
		x

Add: Loan stock appearing in subsidiary company statement of financial position	x
Less: Loan stock of subsidiary company held b holding company	(x)
Group loan stock	x

Steps in preparing the consolidated statement of financial position

Step 1

Prepare the 3 important accounts i.e. - cost of control to determine goodwill

- Group retained profits
- Minority interest

Step 2

Add the assets and liabilities of the subsidiary company to those of the holding company noting the following:

- a) The investment in subsidiary company appearing in the holding company statement of financial position will be excluded from the consolidated statement of financial position and instead we will have goodwill on consolidation.
- b) The ordinary share capital and preference share capital in consolidated statement of financial position will only be that of the holding company. This is because the share capital of the holding company and the subsidiary is split between the cost of control (holding companies share) and the Minority interest.
- c) The group retained profits will be the balance appearing in the group retained profits account and group capital reserves should also be completed the same way company group retained profits. (This means that group capital reserves will be made up of the holding company's capital reserves plus holding companies share of post acquisition capital reserves in subsidiary).
- d) The minority interest will be shown as part of shareholders funds in consolidated statement of financial position but this is after getting the sub-total of the ordinary share capital, preference-share capital, group capital reserves and group retained profits.

Example:

H Ltd owned S Ltd since the date of incorporation of S Ltd. The statement of financial positions of the two companies

as at 31 December 20X2 is as follows.

	H Ltd		S Ltd	
	£	£	£	£
Non Current assets				
Tangible - PPE		35,000.00		45,000.00
Investment in S Ltd		45,000.00		
		80,000.00		45,000.00
Current assets				
Inventory	16,000.00		12,000.00	
Accounts receivables	8,000.00		9,000.00	
Cash at bank	1,000.00	25,000.00	-	21,000.00
TOTAL ASSETS		105,000.00		66,000.00

Share Capital		70,000.00		40,000.00
Retained profits		11,000.00		19,000.00
		<u>81,000.00</u>		<u>59,000.00</u>
Non Current Liabilities				
10% Loan Stock		10,000.00		-
Current Liabilities				
Bank Overdraft	-		3,000.00	
Accounts Payable	14,000.00	14,000.00	4,000.00	7,000.00
		<u>105,000.00</u>		<u>66,000.00</u>

Required;

Prepare the consolidated statement of financial position of H Ltd and S Ltd as at 31 December 20X2

Solution**Consolidate Statement of financial position of H and S Ltd.. As at 31 December 20x2**

NON-CURRENT ASSETS		£	£
Property, plant and equipment (35+45)			80,000
Goodwill			<u>5,000</u>
			85,000
CURRENT ASSETS			
Inventory (16+12)	28,000		
Accounts receivable(8+9)	17,000		
Cash at bank	<u>1,000</u>		<u>46,000</u>
TOTAL ASSETS			<u>131,000</u>
Ordinary share capital			70,000
Retained profits			<u>30,000</u>
			100,000
NON-CURRENT LIABILITIES			
10% Loan stock			10,000
CURRENT LIABILITIES			
Bank overdraft	3,000		
Accounts payables	<u>18,000</u>		<u>21,000</u>
TOTAL EQUITY AND LIABILITIES			<u>131,000</u>

WORKINGS**NOTE:**

H owns S Ltd. since date of incorporation thus:

It owns 100% of S Ltd.. (No minority interest)

There are no pre-acquisition profits (all the profits of share capital are distributable)

Cost of control

	£		£
Investment in S	45,000	OSC (40,000 x 100%)	40,000
	<u>45,000</u>	Goodwill (balance figure)	<u>5,000</u>
			<u>45,000</u>

Group retained profits

	£		£
Balance c/d	30,000	H Ltd..	11,000
	<u>30,000</u>	S Ltd..	<u>19,000</u>
			<u>30,000</u>

Example

Set out below are the draft statement of financial positions of H Ltd and it's subsidiary S Ltd as at 31 December 20X2.

	H Ltd		S Ltd	
	£	£	£	£
Non Current assets				
Tangible - PPE		50,000.00		40,000.00
Inv. S Ltd				
OSC	12,000.00			
PSC	10,000.00			
Loan				
Stock	5,000.00	27,000.00		
		<u>77,000.00</u>		<u>40,000.00</u>
Current assets				
Inventory	12,000.00		10,000.00	
Accounts receivables	8,000.00		4,000.00	
Cash at bank	3,000.00	23,000.00	2,000.00	16,000.00
TOTAL ASSETS		<u>100,000.00</u>		<u>56,000.00</u>
Share Capital				
OSC		50,000.00		30,000.00
PSC		10,000.00		12,000.00
Retained profits		20,000.00		4,000.00
		<u>80,000.00</u>		<u>46,000.00</u>

Non Current Liabilities

10% Loan Stock	10,000.00	6,000.00
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Current Liabilities

Accounts Payable	10,000.00	4,000.00
	<u>100,000.00</u>	<u>56,000.00</u>

Additional information:

H Ltd acquired 60 % of the Ordinary Share capital of S Ltd when the retained profits Amounted to £1,000, 40% of the Preference Share Capital and part of the 10% loan Stock.

Required :

Prepare the consolidated statement of financial position of H Ltd and it's Subsidiary S Ltd as at 31 December 20X2

Solution**H Ltd.. And its subsidiary**

NON-CURRENT ASSETS	£	£
Tangible PPE		90,000
Goodwill		<u>(1,400)</u>
		88,600
CURRENT ASSETS		
Inventory	22,000	
Accounts receivables	12,000	
Cash at bank	<u>5,000</u>	<u>39,000</u>
		<u>127,600</u>
Ordinary share capital		50,000
Preference share capital		10,000
Retained profits		<u>21,800</u>
		81,800
Minority interest		<u>20,800</u>
Shareholders funds		102,600
NON-CURRENT LIABILITIES		
10% loan stock		11,000
CURRENT LIABILITIES		
Accounts payables		<u>14,000</u>
		<u>127,600</u>

Workings:

Group retained profits

£ | £

C.O.C – P & L at Acquisition	600	H. Ltd..	20,000
Minority interest in S	1,600	S Ltd..	4,000
Balance c/d	<u>21,800</u>		
	<u>24,000</u>		<u>24,000</u>

Group Loan Stock

Investment S – Loan	£ 500	H Ltd..	£ 10,000
Balance c/d	<u>11,000</u>	S. Ltd.	<u>6,000</u>
	<u>21,000</u>		<u>21,000</u>

Cost of control

Investment in S – O.S.C	£ 12,000	O.S.C (60% x 30,000)	£ 18,000
P.S.C	10,000	P.S.C (40% x 12,000)	4,800
Goodwill	<u>14,000</u>	P & L (60% x 1,000)	<u>600</u>
	<u>23,400</u>		<u>23,400</u>

Minority interest

Balance c/d	£ 20,800	O.S.C (40% x 130,000)	£ 12,000
		P. S. C (60% x 12,000)	7,200
		P & L (40% x 4,000)	<u>1,600</u>
	<u>20,800</u>		<u>20,800</u>

Group retained profits is made up of:-

H. Ltd.	£ 20,000
H. Ltd.. Share of post acquisition profits in S (60% x (4,000 – 1,000))	<u>1,800</u>
	<u>21,800</u>

Example

H Ltd Acquired S Ltd a few years ago when the Capital and Retained profits stood at £5,000 and £6,000 respectively.

The following statement of financial positions relate to the two companies as at 30 June 20X3.

	H Ltd		S Ltd	
Non Current assets	£	£	£	£
Tangible - PPE		50,000.00		40,000.00
20,000 Ordinary shares in S Ltd		<u>30,000.00</u>		<u> </u>

		80,000.00		40,000.00
Current assets				
Inventory	3,000.00		8,000.00	
Accounts receivables	20,000.00		17,000.00	
Cash at bank	2,000.00	25,000.00	-	25,000.00
TOTAL ASSETS		<u>105,000.00</u>		<u>65,000.00</u>
Ordinary Shares of £1 each		45,000.00		25,000.00
Capital Reserves		12,000.00		5,000.00
Retained profits		<u>30,000.00</u>		<u>23,000.00</u>
		87,000.00		53,000.00
Current Liabilities				
Accounts Payable		18,000.00		12,000.00
		<u>105,000.00</u>		<u>65,000.00</u>

Required :

Prepare the consolidated statement of financial position of H Ltd and it's Subsidiary S Ltd as at 30 June 20X3

Solution

H Ltd. And Its Subsidiary			
Consolidated Statement of financial position as at 20 June 20x3			
	£	£	
NON-CURRENT ASSETS			
Tangible – PPE			90,000
Goodwill			<u>1,200</u>
			91,200
CURRENT ASSETS			
Inventory		11,000	
Receivables		37,000	
Cash at bank		<u>2,000</u>	<u>50,000</u>
			<u>141,200</u>
Ordinary share capital			45,000
Capital reserves			12,000
Retained profits			<u>43,600</u>
			100,600
Minority interest			<u>10,600</u>
Shareholders funds			111,200

CURRENT LIABILITIES

Payables

30,000
141,200

Group retained profits

	£		£
P & L at acquisition	4,800	H. Ltd.	30,000
Minority interest	4,600	S. Ltd.	23,000
Balance c/d	<u>43,600</u>		
	<u>53,000</u>		<u>53,000</u>

Group capital reserves

	£		£
C.O.C capital reserves at acquisition	4,000	H. Ltd.	12,000
M I 's share of P&L in S	1,000	S. Ltd.	5,000
Balance c/d	<u>12,000</u>		
	<u>17,000</u>		<u>17,000</u>

Remember that the holding company has bought 20,000 shares out of the 25,000 shares that the subsidiary company has issued. Therefore the percentage acquired is 80%.

Cost of control

	£		£
Investment in S	30,000	O.S.C (80% x 25,000)	20,000
		Capital (80% x 5,000)	4,000
		P & L (80% x 600)	4,800
		Goodwill	<u>1,200</u>
	<u>30,000</u>		<u>30,000</u>

Minority interest

	£		£
Balance c/d	10,600	O.S.C (20% x 25,000)	5,000
		P. S. C (20% x 5,000)	1,000
		P & L (20% x 23,000)	<u>4,600</u>
	<u>10,600</u>		<u>10,600</u>

INTRA COMPANY ADJUSTMENTS

In preparing the consolidated statement of financial position, the following items may require adjustments:.

- 1 Goodwill
- 2 Unrealized profit on closing inventory
- 3 Unrealized profit on PPE
- 4 Inter company balances
- 5 Proposed dividends by subsidiary
- 6 Fair value of subsidiaries net assets on date of acquisition

1 GOODWILL

Previously under IAS 22 on Business combinations, goodwill on consolidation used to be amortized over an estimated period of years. However, IFRS 3 (still on business combinations) prohibits the amortization Goodwill and instead requires;

- a) Positive goodwill to be carried in the accounts at cost and incase the management feels there's been a loss of value (impairment), then it should be charged as an expense.

For the consolidated statement of financial position, the relevant entry is ;

DR. Group retained profits

CR. Cost of control (with the impairment)

- b) Negative goodwill should be reported as income immediately.
Relevant entries are;;

DR. Cost of control

CR. Group profit and loss/retained profits (with the full negative goodwill)

2 UNREALIZED PROFIT ON CLOSING INVENTORY

Where one company has bought goods from another company in the group and part of these goods are included in the closing inventory, then the selling company is reporting an unrealized profit.

An entry is thus required to reverse the unrealized profit and the overstatement in closing inventory.

The following situation will apply;

- a) If the holding company made the sale,

DR. Group retained profits

CR. Group closing inventory

(with the full unrealized profits).

- b) If Subsidiary company made the sale:

DR. Group retained profits (with holding company share of UP)

DR. Minority Interest (With minority Interest share of U.P)

CR. Group closing inventory (with the full UP)

NOTE:

Where the subsidiary is company makes the sale, its profits are overstated with the unrealized profit and the subsidiary's profit belong to both holding company and minority

interest. Therefore the reversal of the unrealized profit in the situation will also affect the Minority interest.

3 Unrealized profit on Property, Plant and Equipment

Where one company sells an item of PPE to the other company in the group then, this will lead to two main problems.

- a) The selling company will report on unrealized profit because the item of PPE is still used within the group. Whereas the PPE of the buying company will be overstated by the unrealized profit.

An entry is thus required to reverse the unrealized profit and the overstatement. Relevant entries

- i) If the holding company made the sale
- | | |
|-----|------------------------|
| DR. | Group retained profits |
| CR. | Group PPE |
- (With the full unrealized profit)
- ii) If the subsidiary company made the sale,
- | | |
|-----|--|
| DR. | Group retained profits (with holding company's share of unrealized profit) |
| DR | Minority interest (With unrealized profit) |
| CR. | Group PPE (With the full unrealized profit) |

- b) The buying company will charge excess depreciation due to the inflated price of PPE (excess depreciation is the difference between charged to date based on the actual cost of PPE)

This means, that the profits of the buying company are understated and PPE is also understated due to the excess depreciation.

An entry is thus required to write back the depreciation and also the reserve the understatement of the PPE. The following entries are relevant:

If the holding company made the sale and thus the subsidiary company is charging the excess depreciation.

- | | |
|-------|--|
| DR | Group PPE (With the full excess depreciation) |
| CR. | Group retained profits (with holding company share of excess depreciation) |
| CR M2 | (With the minority's share of excess depreciation) |

If subsidiary company made the sale and thus holding company is charging the excess depreciation,

- | | |
|----|------------------------|
| DR | Group PPE |
| CR | Group retained profits |
- (With the full excess depreciation)

4 Inter Company balances

One of the companies may appear as receivable (debtor) or payable (creditor) in the other company's books. Just like in accounting four branches, such inter-company balances should be excluded from the consolidated statement of financial position.

The following situations may therefore apply:

- a) If the inter-company balances are directly opposite and equal i.e. a receivable in one company's books is the same as the payable in the other company's books and these amounts are included in the receivables and payables of the group.

DR. Group accounts payables

CR. Group accounts receivable

(with the full amount due from one company to the other)

If the amounts due from one to the other are shown as separate amounts referred to as current accounts then the amounts or balances are simply ignored and not included in the consolidated statement of financial position.

- b) If the inter-company balances are directly opposite but not equal then the first step will be; To make them equal by adjusting the holding company's balances.
The following items will lead to differences in the inter-company balances

i) Cash in transit

Where one company may have sent cash which is yet to be received by the other company as at the end of the financial period and thus irrespective of the company sending the cash, the following entry will be made;

DR. Group cash at bank

CR. Group accounts receivable/payables.

ii) Goods in transit

Whereby one company has sent goods that are yet to be received by the other company as at the end of the financial period and in most cases it is assumed that the goods are sent at an inflated price and thus there is an unrealized profit thereof.

The relevant entry will be

DR. Group inventory (with the cost of the goods)

DR. Group retained profit (with holding company share of unrealized profit)

DR. M.J (with M.J's share of unrealized profit if it is subsidiary company sending goods)

CR. Group account receivables /payables.

iii) Administration expenses

The holding company may have charged the subsidiary company with its share of administration expenses but this amount is yet to be accrued or accounted for by the subsidiary...

The relevant entry will be;

DR. Group retained profits (with holding company share of admin expenses)

DR. M.I (with M.I share of admin expenses)

CR. Group accounts receivable/payable.

NOTE

The credit entry in group account receivable or payables means that if the subsidiary company is a receivable in the holding company's books, then the credit entry will be made in the group account receivables.

However, if subsidiary company is a payable, then the credit entry will be made in the group account payables.

If the holding company accounts are showing a separate current account for the subsidiary, then the credit entry will be made in this current account.

Once adjustments have been made of the above items, the inter-company balances should agree and the entry to make them cancel out will be passed and the position in situation (a) above will apply.

4 Proposed dividends by subsidiary company

If the subsidiary company has proposed some dividends appearing under current liabilities then the dividends are payable to the holding company and minority interest.

The share that belongs to the Minority Interest will remain as a current liability and will be added to the proposed dividends of the holding company to form the group proposed dividends.

However, the share that belongs to the holding company is a form of inter-company balance and should thus be excluded from the consolidated statement of financial position.

The following entries are relevant;

- a) If the holding company has accrued its share of proposed dividends.
DR. Group proposed dividends
CR. Group receivables (includes dividends receivable)
- b) If the holding company has not accrued for the share of its proposed dividends
DR. Group proposed dividends
CR. Group retained profits.

5 Fair value adjustment

IFRS 3 requires that goodwill on consolidation should be based on the fair values of the net assets of the subsidiary company on the date of acquisition.

This means that the subsidiary company should revalue its assets on the date of acquisition. But unfortunately no revaluation may have been done. For the purpose of consolidation, it is important to determine what should have been the revaluation gain or loss if an asset is revalued. In most cases we revalue non current assets such as Property, plant and equipment, intangible assets and long term investments. If there is a revaluation gain on any of the assets then the following entry will be made:

- a) To record the revaluation gain
DR. Group PPE/intangible assets/Longterm investments (with the full revaluation gain)
CR. Cost of control (with holding company share of revaluation gain)
CR. M.I (with M.I's share of the revaluation gain)

For assets that are meant to be depreciated or amortized, (PPE and Intangibles), the total depreciation or amortization that should be charged to date should be estimated and provided for .

- b) Compute the additional depreciation that should have been provided to date had the subsidiaries assets been revalued and record the amount as follows;
DR. Group retained profits (with holding company share of additional depreciation)
DR. M.I (with M.I's share of additional depreciation)

CR. Group PPE/Intangible assets (with the full additional depreciation)

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Example

The following statement of financial positions relate to H Ltd and S Ltd as at 31 December 20X2.

	H Ltd		S Ltd	
	£	£	£	£
Non Current assets				
Tangible				
Land		100,000.00		50,000.00
Buildings		150,000.00		80,000.00
Plant		80,000.00		50,000.00
		<u>330,000.00</u>		<u>180,000.00</u>
Investment in S Ltd		100,000.00		
Current assets				
Inventory	60,000.00		40,000.00	
Accounts receivables	80,000.00		50,000.00	
Cash at bank	25,000.00	165,000.00		90,000.00
TOTAL ASSETS		<u>595,000.00</u>		<u>270,000.00</u>
Ordinary Shares of £1 each		200,000.00		100,000.00
Capital Reserves		100,000.00		40,000.00
Retained profits		90,000.00		50,000.00
		<u>390,000.00</u>		<u>190,000.00</u>
Non Current liabilities				
10% Loan Stock		100,000.00		20,000.00
Current Liabilities				
Bank Overdraft	-		10,000.00	
Accounts payables	80,000.00		30,000.00	
Proposed dividends	25,000.00	105,000.00	20,000.00	60,000.00
		<u>595,000.00</u>		<u>270,000.00</u>

Additional information

- i) H ltd acquired the investment in S Ltd on 1 Jan 20X0 as follows:

	£
60% Ordinary shares	90,000.00
Loan Stock	10,000.00
	<u>100,000.00</u>

- ii) On the date of acquisition the capital reserves of S ltd amounted to £10,000 and retained profits amounted to £5,000. On the same date the fair values of land and buildings were £10,000 and £20,000 respectively above the carrying amounts. Although no depreciation

is provided on land, buildings are depreciated at 5% p.a. on cost.

- iii) Included in the inventory of H Ltd are goods purchased from S Ltd at a selling price of £15,000 to S Ltd. S Ltd reported a profit of 50% on cost.
- iv) Included in the plant of S Ltd is plant bought from H Ltd on 01.01.20X1 at a price of £20,000. H Ltd reported a profit of a third on cost. The group provides depreciation on 30% on reducing balance.
- v) H Ltd has not yet accounted for its share of proposed dividends in S Ltd.
- vi) Included in the accounts payable of H Ltd is an amount of £25,000 due to S Ltd. This amount stood at £28,000 in the books of S Ltd. The difference was due to the following items:
 - Cash sent by H Ltd to S Ltd of £1,000.
 - Goods sent to H Ltd by S Ltd but not yet received by H Ltd. Selling price to H Ltd was £1,200.
 - Administration fees of £800 charged by H Ltd to S Ltd but not yet recorded by S Ltd.
- vii) Assume that goodwill on consolidation has been impaired by 40%.

Required:

Prepare the consolidated statement of financial position of H Ltd and its subsidiary as at 31.12.20X2.

Solution

H Ltd.. And its Subsidiary		
Consolidated Statement of financial position as at 31/12/200		
	£	£
NON-CURRENT ASSETS		
Property, plant and Equipment		534,550
Goodwill		<u>1,200</u>
		535,750
CURRENT ASSETS		
Inventory	95,800	
Receivables	102,000	
Cash at bank	26,000	223,800
TOTAL ASSETS		759,550
Ordinary share capital		200,000
Capital reserves		118,000
Retained profits		<u>118,210</u>
		436,210
Minority interest		<u>85,340</u>
Shareholders funds		521,550

NON-CURRENT LIABILITIES

10% Loan stock

110,000

CURRENT LIABILITIES

Payables

85,000

Bank overdraft

10,000

Proposed dividends

33,000128,000759,550

Workings

Group PPE

H Ltd.	330,000	Dep. On fair value (5% x 20,000 x 3 yrs)	
S Ltd.	150,000	P & L (60% x 3,000)	1,800
Fair value adjust		M.I (40% x 3,000)	1,200
C.O.C (60% x 30,000)	18,000	UP on PPE (H made sale)	
M I (40% X 30,000)	12,000	P & L (1/3/1,1/3 x 20,000)	5,000
Excess depreciation		Balance c/d	534,550
P & L (0.6 x 2,550)	1,530		
M. P (0.4 x 2,550)	<u>1,020</u>		
	<u>542,550</u>		<u>534,550</u>

Cash at bank

H Ltd..	£ 25,000	Balance c/d	£ 26,000
Payables CIT	<u>1,000</u>		
	<u>26,000</u>		<u>26,000</u>

Group capital reserves

C.O.C at acquisition	£ 6,000	H Ltd..	£ 100,000
Minority interest share	16,000	S Ltd.d	40,000
Balance c/d	<u>118,000</u>		
	<u>140,000</u>		<u>140,000</u>

Group inventory

H Ltd.	60,000	UP on closing stock (S made Sale)	
--------	--------	-----------------------------------	--

S Ltd.	40,000	P & L (60% x 50/150 x 15,000)	3,000
Payables UP (GIT)	800	M I (40% x 50/150 x 150,000)	2,000
		Balance c/d	<u>95,800</u>
	<u>100,800</u>		<u>100,800</u>

Group inventory

Receivables	£ 28,000	H Ltd..	£ 80,000
		S Ltd.	30,000
		Cash at bank – CIT	1,000
		Goods in transit	
		Inventory (100/150 x 1,200)	800
		P & L (60 x 150/150 x 1,200)	240
		M.I (40% x 50/150 x 1,200)	160
		Administration expenses	
Balance c/d	85,000	P & L (60% x 800)	480
		Minority Interest (40% x 800)	<u>320</u>
	<u>113,000</u>		<u>113,000</u>

Group receivables

H Ltd.	£ 80,000	Payables	£ 28,000
S Ltd.	<u>50,000</u>	Balance c/d	<u>102,000</u>
	<u>130,000</u>		<u>130,000</u>

Group Loan Stock

Cost of investment in S	£ 10,000		£ 100,000
Balance c/d	110,000		<u>20,000</u>
	<u>120,000</u>		<u>120,000</u>

Group proposed dividends

P & L (60% x 20,000)	£ 12,000	H Ltd..	£ 25,000
Balance c/d	<u>33,000</u>	S Ltd..	<u>20,000</u>
	<u>45,000</u>		<u>45,000</u>

Cost of control

Cost of investment in S	£ 90,000	O.S.C (60% x 100,000)	£ 60,000
		Capital reserve (60% x 10,000)	6,000

	P & L (60% x 5,000)	3,000
	PPE fair value adj.	18,000
	Goodwill balance figure	
	P & L impaired	1,800
	Balance – statement of financial position	<u>1,200</u>
<u>90,000</u>		<u>90,000</u>

Minority interest

	£		£
PPE – fair value depreciation	1,200	O.S.C (40% x 100,000)	40,000
Inventory – UP	2,000	Capital reserve (40% x 40,000)	16,000
Payables UP GIT	160	P & L (40% x 50,000)	20,000
Payables administration	320	PPE fair value adj.	12,000
		PPE Excess depreciation	1,020
Balance c/d	<u>85,340</u>		
	<u>89,020</u>		<u>89,020</u>

Group retained profits

	£		£
COC (P & L at acquisition)	3,000	H Ltd..	90,000
Minority interest share	20,000	S Ltd..	50,000
PPE fair value depreciation	1,800	PPE excess depreciation	1,530
Investment Unrealized profit	3,000	Proposed dividends	12,000
PPE – Unrealized profit	5,000		
Payables UP (GIT)	240	Balance c/d	118,210
	480		
Payables – administration			
COC GN impaired	<u>1,800</u>		
	<u>153,530</u>		<u>153,530</u>

Ensure that you have mastered the intra group adjustments because all consolidation questions must have one or several of these adjustments. We shall deal with further examples as we proceed on.

OTHER ASPECTS OF THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

The consolidated statement of financial position may require a special approach under the following situations;

- Pre-acquisition losses in subsidiary company on date of acquisition.
- Acquisition during the financial period (particularly during the financial period);
- Group structures

i) Pre-acquisition losses in subsidiary company on date of acquisition

If the subsidiary company has a loss on the date of acquisition i.e. a debit balance in the retained profits (profit and loss) account, then in computing good will, the entry to cost of control of profit and loss on acquisition will be reversed as follows.

DR. Cost of control

CR. Group retained profits

(With the holding company's share of the loss)

ii) Acquisition during the financial period

The holding company may acquire the subsidiary company partway through the financial period such that as at the statement of financial position date, the subsidiary company has been held for a period of less than 12 months.

The consolidation procedure does not change because we are dealing with the assets and the liabilities of the two companies as at a certain date..

However, the following two points need to be considered;

a) Computation of retained profits acquisition

As the holding company has acquired the subsidiary company while trading is taking place, then it may be difficult to determine retained profits as acquisition, unless financial amounts of subsidiary company are prepared.

Therefore, to simplify the computations of retained profits on acquisition, we normally assume that the retained profits for the year of the subsidiary company accrue evenly and they can be split between the pre-acquisition and post acquisition based on the months.

Thereafter, the retained profits on acquisition are given as follows;

Retained profits on acquisition = Retained profits b/d + Re-acquisition retained profits for the year.

Example;

Assume that H Ltd.. Acquired 80% of S Ltd.. On 1st April, 2003. The retained profits of the subsidiary company b/d amounted to £ 120,000 and the c/d amounted to £150,000.

REQ. Compute the retained profits on date of acquisition and the amount to be transferred to the cost of control if the financial year end is 31/12/03

$$\begin{aligned} \text{Retained profits for the year ; } & \text{Bal c/d} - \text{Bal b/d} \\ & 150,000 - 120,000 \\ & = 30,000 \end{aligned}$$

$$\text{Pre-acquisition profits ; } 1^{\text{st}} \text{ Jan } 03 - 31^{\text{st}} \text{ March } 03 = \frac{1}{4} \times 30,000 = 7500$$

$$\begin{aligned} \text{Retained profits on acquisition} &= \text{bal b/d} + \text{pre-acquisition} \\ &= 120,000 + 7500 \\ &= \text{£}127,000 \end{aligned}$$

$$\begin{aligned} \text{iii) To cost of control} & \\ &= 80\% \times 127,000 \\ &= \text{£}102,000 \end{aligned}$$

b) Pre-acquisition dividends

Pre-acquisition dividend is dividend paid by the subsidiary company out of pre-acquisition profit or it is the dividend that is received or receivable by the holding company from the subsidiary company that relates the period before acquisition.

Thus if the holding company has owned the subsidiary company for a period of less than 12 months and the holding company receives some share of dividends paid from the subsidiary company then the holding company will receive some pre-acquisition dividends.

The computation of pre-acquisition dividend is also simplified because we normally assume that the total dividends of the subsidiary (paid and proposed) accrue evenly and they can be split between pre-acquisition and post acquisition.

Thereafter, pre-acquisition dividend to costs of control is given company;

	£
Holding co. share of dividends in subsidiary company (received + receivable) made up of:	
i) Holding company's share of interim dividends received	x
ii) Holding company's share of proposed dividends receivable	<u>x</u>
	x
Less: holding company's share of post acquisition dividends in subsidiary	<u>(x)</u>
Pre-acquisition dividends to cost control	<u>x</u>

Example

H Ltd.. Acquired 80% of S Ltd. during the year ended 31/12/04. S Ltd. paid an interim dividend of 40,000 on 30th September and as at 31/12/04 has proposed a dividend of 60,000.

Required

Compute the pre-acquisition dividend to cost of control assuming that H Ltd. acquired S Ltd. on the following dates;

- i) 1st July, 2004, ii) 1st October, 2004 – H did not receive share of interim dividend.

		1/7/2004	1/10/2004
		£	£
Total dividends	: Paid	40,000	40,000
	Proposed	<u>60,000</u>	<u>60,000</u>
		<u>100,000</u>	<u>100,000</u>
Post acquisition dividends	(6/12 x 100,000)	50,000	25,000
Pre-acquisition dividend to cost of control			
Holding company share of dividend:			
	Interim receive (80/100 x 40,000)	32,000	
	Interim proposed (80/100x 60,000)	<u>48,000</u>	<u>48,000</u>
		<u>80,000</u>	<u>48,000</u>
Less: Holding company			

share of post acquisition of dividends	(80/100 x 50,000)	<u>40,000</u>	<u>(20,000)</u>
		<u>40,000</u>	<u>28,000</u>

NOTE:

Pre-acquisition dividends may also arise in the following situations;

- i) Where the holding company acquires the subsidiary company's shares cum-dividend and thus dividends eventually received will all be pre-acquisition.
- ii) If the subsidiary company makes post-acquisition losses, and pays out dividends then this dividends are assumed share come out of the pre-acquisition profits and are thus pre-acquisitioned.

For example; If we assume that S Ltd.. was acquired on 1st January 2001 and S Ltd.. had a credit balance in the Profit and loss of £10,000. Then in year 2001 the company makes a post acquisition loss of £2,000 but decides to pay dividends anyway, all these dividend is assumed to be paid out pre-acquisitioned profits of £10,000.

Example July 2000

The following is a summary of the balances in the records of Kwa Limited and its subsidiary Jomvu Limited as at 31 March 2000.

	Kwa Ltd	Jomvu Ltd
	Sh.'000'	Sh.' 000'
Property, plant and equipment at cost	250,000	220,000
7,500,000 ordinary shares in Jomvu Ltd. at cost	165,000	
6,000,000 preference shares in Jomvu Ltd. at cost	60,000	
Sh.5,000,000 6% debentures of Jomvu Ltd.	5,000	
Current assets	1455000	143,400
	<u>625000</u>	<u>363400</u>
Authorised and issued capital, fully paid: Ordinary shares of Sh.10 each	300,000	100,000
7% non-cumulative preference shares of Sh.10 each		80,000
General reserves	50,000	40,000
Profit and loss account	98,500	44,400
Provision for depreciation	60,000	30,000
6% debentures		20,000
Proposed dividends:	30,000	10,000
On preference shares		5,600
Debenture interest accrued		1,200
Trade payables	<u>87,000</u>	<u>32 200</u>
	<u>625500</u>	<u>363,400</u>

You ascertain the following:

- 1.Kwa Limited acquired the shares of Jomvu Limited, cum dividend on 31 March 1999.
2. The general reserve of Jomvu Limited was the same on 31 March 1999 as on 31 March 2000.
The balance on the income statement of Jomvu Limited is made up as follows:

Sh.'000'

Balance on 31 March 1999	28,000
Net Profit for the period ended 31 March 2000	<u>32,000</u>
	60,000
Less: proposed dividends	<u>15,600</u>
	44,400

- The stock in trade of Jomvu Limited on 31 March 2000 included Sh.6 million in respect of goods purchased from Kwa Limited. These goods had been sold by Kwa Limited to Jomvu Limited at such a price as to give Kwa Limited a profit of 20% on the invoice price.
- The balance on the income statement of Jomvu Limited on 31 March 1999, is after providing for preference dividend of Sh.5,600,000 and a proposed ordinary dividend of Sh.5,000,000, both of which were subsequently paid and credited to the income statement of Kwa Limited.
- No entries have been made in the books of Kwa Limited in respect of the debenture interest due from, or the proposed dividends of Jomvu Limited for the year ended 31 March 2000.
- On 31 March 2000, the authorised and issued ordinary share capital of Jomvu Limited had been increased by Sh.20 million by capitalizing part of the general reserve and issuing 2 million Sh.10 shares to the existing shareholders in proportion to their existing holdings. The transaction has not yet been reflected in the books of Kwa Limited or Jomvu Limited.
- Group policy is to amortise goodwill on consolidation over 5 years using the straight-line method. (Assume goodwill has been impaired at 50%)

Required

The consolidated statement of financial position of Kwa Limited and its subsidiary company Jomvu Limited as at 31 March 2000.

(20 marks)

Note: in this question, the subsidiary company was acquired at the start of the year. At that time the subsidiary company had proposed dividends which the holding company received in the current year. The illustration is important to show how to treat the preacquisition dividends and further inter company adjustments.

Kwa Ltd. and its subsidiary
Consolidated statement of financial position as at 31 March 2000

	Sh. Mill	Sh. Mill
NON-CURRENT ASSETS		
Property, plant and Equipment		380
Goodwill		<u>24.84</u>
		404.84
CURRENT ASSETS		
Current assets		<u>287.7</u>
TOTAL ASSETS		<u>692.54</u>
Ordinary share capital		300
Preference share capital		-
General reserves		50
Retained profits		<u>107.44</u>
		457.44
Minority interest		<u>66.1</u>
Shareholders funds		523.54
NON-CURRENT ASSETS		
6% debentures		15

CURRENT ASSETS

Payables (87 + 32.2)	119.2	
Accrued interest on debenture	0.9	
Proposed dividends	<u>33.9</u>	<u>154</u>
		<u>692.54</u>

Working

Cost of control

	Sh. 'M'		Sh. 'M'
Cost of investment OSC	165	O.S.C (75% x 120,000)	90
PSC	60	PSC (75% x 80,000)	60
		GR (75% x 20)	15
		P&L (75% x 28)	21
		P & L Pre-acquired dividend	
		OSC + PSC	7.95
		GW – P&L (impaired)	6.21
		Balance c/d	<u>24.84</u>
	<u>225</u>		<u>225</u>

Group Retained profits

	Sh. 'M'		Sh. 'M'
C.O.C P&L at acquisition	21	K	98.5
MR (P&L) (25% x 44.4)	11.1	J Ltd.	44.4
Pre-acquisition dividend		.proposed dividends	
OSC (75% x 5)	3.75	O.S.C (75% x 10)	7.5
PSC (75% x 5.6)	4.2	PSC (75% x 5.6)	4.2
C.A (.UProfit) (20% x 6)	1.2	Accrued interest	
C.O.C GW (impairment)	6.21	Share of K (5/20 x 1.2)	0.3
	<u>107.44</u>		
	<u>154.9</u>		<u>154.9</u>

Group Current Assets

	Sh. 'M'		Sh. 'M'
Balance b/d – K	145.5	P & L – U.P.C.S (20% x 6m)	1.2
J	<u>143.4</u>	Balance c/d	<u>287.7</u>
	<u>288.9</u>		<u>288.9</u>

Group Proposed dividends			
Sh. 'M'		Sh. 'M'	
P & L - OSC (75% x 10)	7.5	J. Ltd.	30
PSC (75% x 5.6)	4.2	K Ltd. – OSC	10
Balance c/d	<u>33.9</u>	PSC	<u>5.6</u>
	<u>45.6</u>		<u>45.6</u>
Minority Interest			
Sh. 'M'		Sh. 'M'	
Balance c/d	66.1	O.S.C (25% x 120)	30
		PSC (25% x 80)	20
		GR (25% x 20)	5
		P & L (25% x 44.4)	<u>11.1</u>
	<u>66.1</u>		<u>66.1</u>
Group Accrued Interest			
Sh. 'M'		Sh. 'M'	
P & L share 5/20 x 1.2)	0.3	J Ltd.	1.2
Balance c/d	<u>0.9</u>		<u>—</u>
	<u>1.2</u>		<u>1.2</u>

NOTE: (From additional inform no.6)

The bonus share has been funded using the pre-acquisition reserves and thus it should not affect the computation of goodwill because in making entries to the cost of control, we could have used the increased share capital of sh.120 million and reduced the General Reserve to sh.20 million or have it remain at OSC – sh.100m and General Reserve sh.40M.

However, if subsidiary company makes a bonus issue out of post-acquisition reserves e.g. from retained profits, then we will still need to get the share capital and reserves of subsidiary on date of acquisition and use these values to compute goodwill.

The remaining share capital that has been increased by way of bonus issue will be split between holding company and Minority interest. Then, the amount that belongs to holding company will be shown as any other part of capital reserves or separately in consolidated statement of financial position.

The share that belongs to minority interest will be transferred to minority account.

3 GROUP STRUCTURES

A group structure is the relationship between the holding company and its subsidiaries. There are normally four main types of group structures (apart from the holding company and one subsidiary) i.e.

- i) Holding company with more than one subsidiary company,
- ii) Holding company with a subsidiary company that has a subsidiary company (Sub-sub-sidiary),
- iii) Holding company with direct investment in sub-sub-sidiary company,

iv) Multiple group structures

a) Holding company with more than one subsidiary company

Under this type of structure, the holding company controls more than one company. For example H ltd may Own 80% of S1, 75% of S2 and 60% of S3.

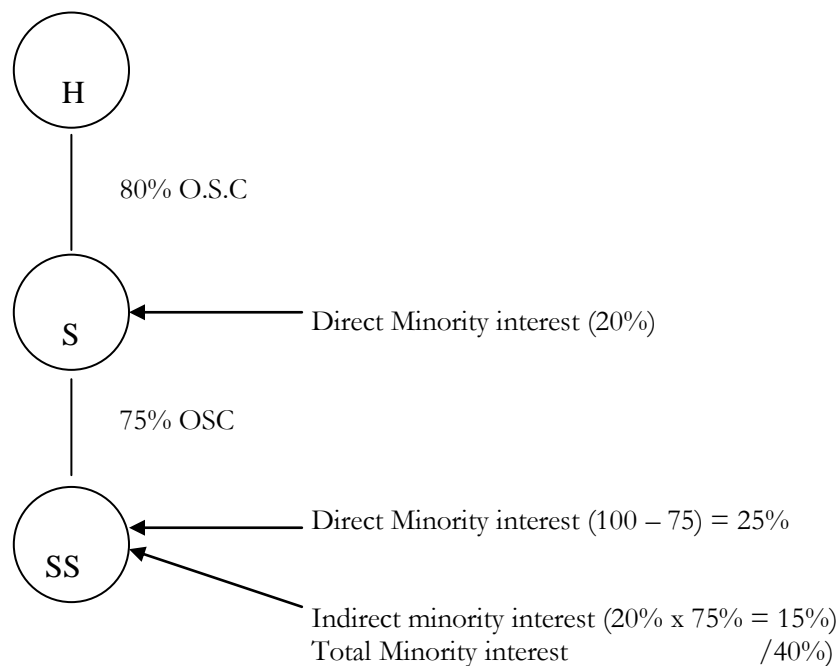
The consolidated statement of financial position will remain as before because it involves adding the assets and liabilities of all subsidiaries to those of the holding company while excluding inter-company balances.

However, separate cost of controls will need to be prepared for each subsidiary company because the dates of acquisition may be different and the goodwill impaired also.

In the consolidated statement of financial position, the remaining goodwill can be shown as one figure.

b) Holding company with a subsidiary and a sub-subsidiary

Where the subsidiary company has another subsidiary company, then that subsidiary is referred to as a sub-subsidiary company of the holding company. This can be shown as follows:



The preparation of the consolidated statement of financial position again remains the same as before because the process involves adding the assets and liabilities of the subsidiary and sub subsidiary to those of the holding company.

However, the following points are important:

- i) The first approach is to determine the effective shareholding by the holding company and Minority Interest in the sub-subsidiary company.
For the holding company the effective shareholding is given as:

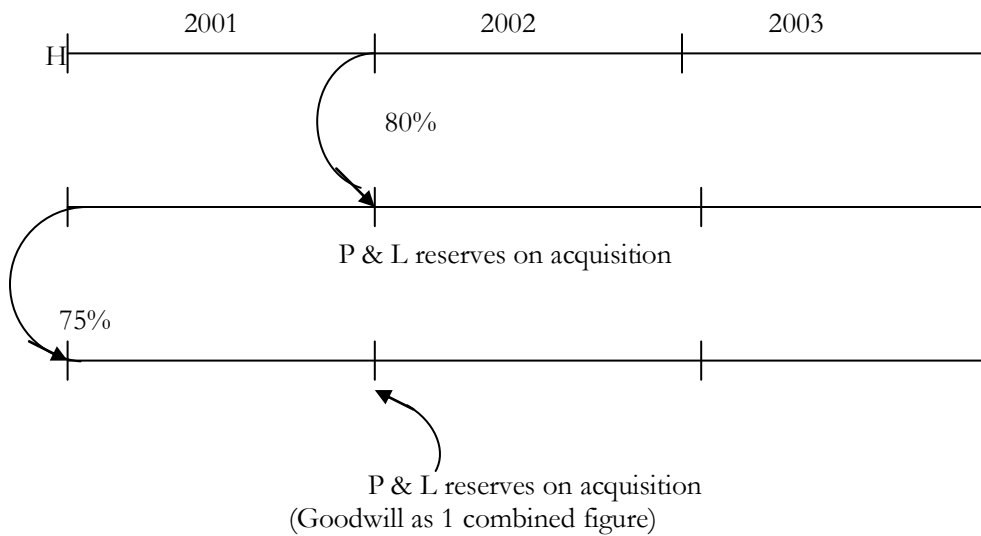
$$80\% \times 75\% = 60\%$$

and the minority interest will be computed in 2 stages: - i.e.

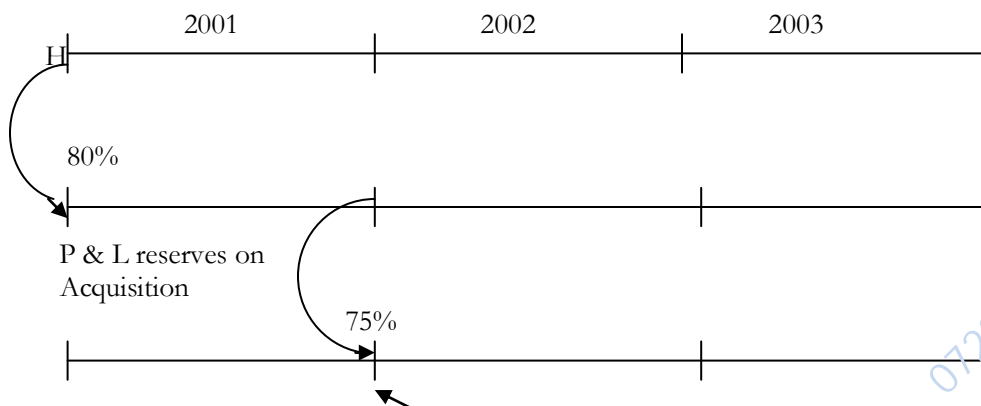
$$\left. \begin{array}{l} \text{Direct minority interest } (100\% - 75\%) = 25\% \\ \text{Indirect minority interest } (20\% \times 75\%) = 15\% \end{array} \right\} \text{TOTAL Minority interest} = 40\%$$

ii) Care should be taken when computing goodwill. The following approach will normally be used:

If the holding company acquired the subsidiary company after the subsidiary company has acquired the subsidiary company, the goodwill can be computed as a combined figure and the profit and loss and capital reserves on acquisition of the subsidiary company will be on the same date the holding company acquired subsidiary company.



If the holding company acquires the subsidiary company and thereafter the subsidiary company acquires the sub-subsidiary company then goodwill should be computed in two stages i.e. At the point when the holding company acquired subsidiary company and on the date when the group acquired the sub-subsidiary company.



P & L reserves on acquisition
(Separate figure for goodwill)

NOTE:

Goodwill is still computed using a single cost of control for both situations only that the first part of the cost of control deals with the subsidiary and second part deals with the sub-subsidiary. The investment in sub-subsidiary appearing in the statement of financial position of the subsidiary belongs to the holding company (80%) and the direct minority interest in S (20%).

The holding company's share is debited to the cost of control and the minority interest is also debited in minority interest account.

iii) Care should be taken when dealing with the proposed dividends in the sub-subsidiary company. This is because these dividends will belong to the subsidiary company at 75% and the direct minority interest in the sub-subsidiary company 25%.

The share that belongs to the direct minority interest will remain in group proposed dividend as a current liability while the share that belongs to the subsidiary company will be dealt with as follows:

DR Group proposed dividends (75%)
 CR Group retained profits (With holding company share 80% x 75%)
 CR Minority interest (With minority interest share 20% x 75%)

Example

The draft Statement of financial positions of UNA Limited, KMN Limited and LLE Limited are as follows: UNA Limited and KMN Limited are both listed on the Nairobi Stock Exchange.

**Statement of financial positions as at 30
September 1996**

	UNA Ltd. Sh.Million	KMN Ltd. Sh.Million	LLE Ltd. Sh.Million
	684	430	330
Investments			
At cost: Shares in KMN Ltd.	600		
At a valuation:			
Shares in LLE Ltd.		360	
Current Assets:			
Stocks	484	320	270
Debtors	180	150	90
Cash at bank	—	80	40
	664	550	400
Current Liabilities:			
Bank overdraft	60	-	
Creditors	170	120	90
Taxation	60	50	40
Proposed dividends (Gross)	100	100	50
	390	270	180
Net Current Assets	274	280	220

	1 558	1.070'	550
Financed by:			
Sh. 10 Ordinary shares	500	500	250
10% Preference shares		80	
Revaluation reserve		30	
Profit and loss account	1.058	460	300
	1,558	1,070	550

Notes:

- UNA Ltd. purchased 60 % of the ordinary share capital and 30 % of the preference share capital of KMN Ltd. on 1 October 1992, when the balances on the Profit and Loss Accounts of UNA Ltd., KMN Ltd. and LLE Ltd. were Sh.899 million, Sh.360 million and Sh. 150 million respectively.
- KMN Ltd. had purchased 70% of the ordinary share capital of LLE Ltd. on 1 October 1991 for Sh.330 million when the balance on the Profit and Loss Accounts of UNA Ltd., KMN Ltd. and LLE Ltd. were Sh.856 million, Sh.330 million and Sh. 130 million respectively. The investment was revalued upwards by Sh.30 million on 30 September 1995. The directors of KMN Ltd. had decided to revalue the investment at Sh.378 million at 30 September 1996, but this has not yet been reflected in the books.
- KMN Ltd. makes sales to both UNA Ltd. and LLE Ltd. at normal selling price (cost plus a mark-up of 33 $\frac{1}{3}$ %). At 30 September 1996, items purchased by UNA Ltd. and LLE Ltd. from KMN Ltd. remaining unsold had cost Sh.24 million and Sh. 16 million respectively. Group policy on unrealised intra-group profits is in line with current international practice i.e. unrealised profits are eliminated in full from the book value of assets, and from the interests held by the group and the minority interest in respective proportion to their holdings in the company which had made the profit.
- UNA Ltd. and KMN Ltd. have not yet accounted for the dividends receivable.
- Intra-group balances are included in debtors and creditors as follows:

UNA Ltd.:	Creditors	LLE Ltd.	Sh. 18 million
	Debtors	KMN Ltd	Sh.8 million
KMN Ltd.:	Creditors	LLE Ltd.	Sh.6 million
LLE Ltd.:	Debtors	UNA Ltd.	Sh.18 million
		KMN Ltd	Sh.6 million

- KMN Ltd. had made out a cheque for Sh.10.4 million on 30 September 1996; this cheque was received by UNA Ltd. on 30 October 1996 and had not been included in UNA Ltd.'s statement of financial position. This Sh.10.4 million includes the preference dividend due to UNA Limited.
- Assume that goodwill on consolidation has been impaired at 80%.

Required:

Consolidated Statement of financial position of UNA Ltd. and its subsidiaries as at 30 September 1996, complying, so far as the information will allow, with the accounting requirements of the IFRS. **(25 marks)**

Solution

UNA Ltd. And its subsidiaries
Consolidated Statement of financial position as at 30th September 1996

	Sh Mill	Sh. Mill
NON-CURRENT ASSETS		
Property, plant and equipment		1,444
Goodwill		<u>18</u>
		1,462
CURRENT ASSETS		
Inventory	1,064	
Receivables	388	
Cash at bank	<u>120</u>	<u>1,572</u>
TOTAL ASSETS		<u><u>3,034</u></u>
EQUITY AND LIABILITIES		
Ordinary share capital		500
RESERVES		
Retained earnings		<u>1,186.4</u>
		1,686.4
Minority interest		<u>637</u>
Shareholders funds		2,23.4
CURRENT LIABILITIES		
Bank overdraft	496	
Payables	356	
Current tax	155	
Proposed dividends	<u>150</u>	<u>710</u>
TOTAL EQUITY AND LIABILITIES		<u><u>3,034</u></u>

Minority Interest			
	<u>Sh.Mill</u>		<u>Sh.Mill</u>
Investment in LLE		<u>KMN</u> OSC (40% x 500)	200
40% x 330)	132	PSC (70% x 80)	56
Unrealised profit on closing		Pel (40% x 460)	184
stock (40% x 10m)	4	<u>LLE</u> OSC (58% x 250)	145
Bal c/d	637	Pel (58% x 300)	174
		Proposed dividend (share in LLE)	
		40% x 70% x 50	14
	773		773
	===		===

Group Receivables			
	<u>Sh.Mill</u>		<u>Sh.Mill</u>
UNA	180	Bank overdraft – CIT	8
KMN	150	Payables due to LLE	18
LLE	90	Due to LLE	6
		Bal c/d	388
	420		420
	===		===

Cost on control			
	<u>Sh.Mill</u>		<u>Sh.Mill</u>
Investment in KMN	600	<u>KMN</u> OSC (60% \times 500)	300
		PSC (30% \times 80)	24
		Pel (60% \times 360)	216
		<u>LLE</u> OSC (42% \times 250)	105
		Pel (42% \times 150)	63
		Goodwill-balancing figure	
		Impaired – Pel	72
		Bal c/d – b/s	<u>18</u>
	<u>798</u>		<u>798</u>

Retained Profits			
	<u>Sh.Mill</u>		<u>Sh.Mill</u>
C.O.C Pel at acquisition (60% \times 500)	216	UNA	1058
M.I share in KMN	184	KMN	460
C.O.C Pel at acquisition-LLE	63	LLE	300
		<u>Group proposed did</u> – share of KMN	60
		(60% \times 100)	
M.I share in LLE	174	Share of UML(60% \times 70% \times 50)	21
C.O.C –impaired Goodwill	72	Bank overdraft CIT –pref div	2.4
Group inv. Unrealized profit on closing stock	6		
Bal c/d	<u>1186.4</u>		
	<u>1901.4</u>		<u>1901.4</u>

Group payables			
	<u>Sh.Mill</u>		<u>Sh.Mill</u>
Receivable due from UNA	18	UNA	170
Due from KMN	6	KMN	120
Bal c/d	<u>356</u>	ULA	<u>90</u>
	<u>380</u>		<u>380</u>

Group Inventory

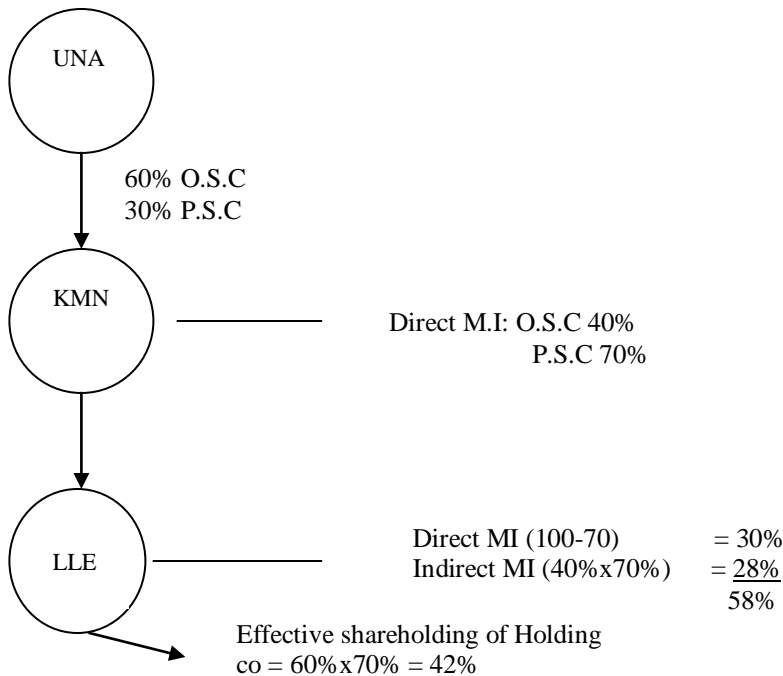
	<u>Sh.Mill</u>		<u>Sh.Mill</u>
UNA	484	Unrealised profit on closing stock- Pel	6
KMN	320	Unrealised profit on closing stock - MI	4
LLE	<u>270</u>	Bal c/d	<u>1064</u>
	<u>1074</u>		<u>1074</u>

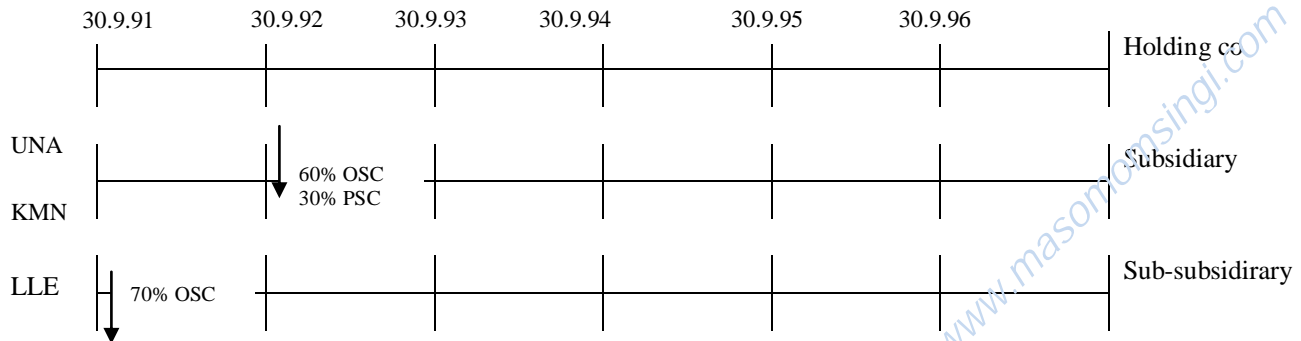
Group Proposed Dividends

	<u>Sh.Mill</u>		<u>Sh.Mill</u>
Pel (60%x100)	60	UNA	100
Pel – share of UML	21	KMN	100
MI – share of UML	14	LLE	50
Bal c/d	<u>155</u>		<u>250</u>
	<u>250</u>		<u>250</u>

Bank overdraft

	<u>Sh.Mill</u>		<u>Sh.Mill</u>
CIT-receivables	8	UNA	60
Pel (pref div – 10%x80x30%)	2.4		
Bal c/d	<u>49.6</u>		
	<u>60</u>		<u>60</u>





- Goodwill will be computed as a single figure. Pel on acquisition (30.09.92) = KMN = 360M and LLE = 150M

NOTE:

1. For the purpose of computing goodwill, the investment in the subsidiary and the subsidiary should not be revalued and thus any revaluation carried out should be revealed first before consolidation is done.
2. Even though the effective control of the holding co. may be less than 50% in the sub-subsidiary co. the sub-subsidiary co is considered to be under the control of the holding company and thus should be consolidated the normal way. This is because the holding company has indirect control in the sub-subsidiary company

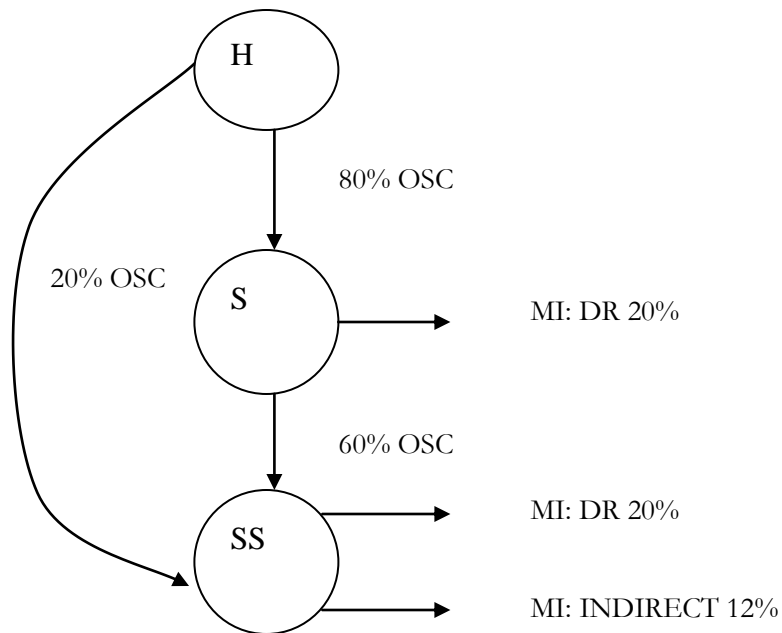
NOTE;

- 1) For the purpose of computing goodwill, the investment in the subsidiary of the sub-subsidiary should not be revalued and thus any revaluation carried out should be reversed first before consolidation is done.
- 2) Even though the effective control of the holding company may be less than 50% on the subsidiary company sub-subsidiary company is considered to be under the control of the holding company and thus should be consolidated the normal way. This is because the holding company has an indirect control in the sub-subsidiary company.

c) Holding company with a direct shareholding in sub-subsidiary company

Under this type of structure, both the holding and subsidiary company have some shareholding in the sub-subsidiary company. The consolidation process will also remain the same as the second type of structure only that this time care should be taken in dealing with the following items.

- 1) The effective shareholding of the holding company will now be both direct and indirect. E.g. Assume the following structure.



The same approach will be used as that of the previous structure. The following additional points need to be considered:

- II) On the debit side of the cost of control, the investment in subsidiary and sub-subsidiary will appear as follows;

On the section of the subsidiary, we will have the cost of investment in subsidiary appearing in holding company's statement of financial position.

On the section dealing with the sub-subsidiary, we will have the cost of investment in sub-subsidiary appearing in the holding company's books or statement of financial position and the holding

company's share of investment in sub-subsidiary company appearing in the subsidiary's statement of financial position or books.

- iii) The proposed dividends in sub-subsidiary company may also require a different accounting entry and this is because the holding company will now receive its share. Two entries may thus be necessary and these are;

DR. Group proposed dividends (with holding company's direct share in proposed dividend of ss)
CR. Group retained profits

DR. Group proposed dividends (with subsidiary company share of the proposed dividends in sub-subsidiary)

CR. Group retained profits (with holding company's indirect share for proposed dividends in sub-subsidiary)

CR. M.I (with Minority interest's indirect share of proposed dividends in subsidiary)

Example

Rain Ltd., Storm Ltd. and Thunder Ltd. are in the business of manufacturing tents. Their statement of financial positions as at 30 September 2003 were as below:

	Rain Ltd.		Storm Ltd.		Thunder Ltd.	
	Sh.	Sh.	Sh.	Sh.	Sh.	Sh.
	"000"	"000"	"000"	"000"	"000"	"000"
Non-current assets:						
Non-current assets (net of depreciation)		14,000		6,300		1,700
Shares in subsidiaries		<u>5,000</u>		<u>1,900</u>		<u>-</u>
		19,000		8,200		1,700
Current assets:						
Inventory	2,000		1,200		1,600	
Trade payables	4,800		2,000		800	
Cash	<u>2,700</u>		<u>1,400</u>		<u>1,100</u>	
	9,500		4,600		3,500	
Current liabilities:						
Trade payables	(<u>5,000</u>)		(<u>2,600</u>)		(<u>1,800</u>)	
Net current assets		<u>4,500</u>		<u>2,000</u>		<u>1,700</u>
		<u>23,500</u>		<u>10,200</u>		<u>3,400</u>
Financed by:						
Authorised and issued Share capital:						
Ordinary shares of Sh.100		15,000		5,000		2,000

10% preference shares of Sh. 100 each fully paid	-	3,000	-
General reserve	6,000	3,000	1,000
Retained Profits	<u>2,500</u>	<u>(800)</u>	400
	<u>23,500</u>	<u>10,200</u>	<u>3,400</u>

Additional information:

- Rain Ltd. purchased 30,000 ordinary shares in Storm Ltd. on 1 October 2001 for Sh. 3,400,000 and 5,000 preference shares on 1 October 2002 for Sh. 600,000. On 1 October 2002, Rain Ltd. purchased 5,000 ordinary shares in Thunder Ltd. for Sh. 1,000,000. Storm Ltd. purchased 11,000 ordinary shares in Thunder Ltd. for Sh. 1,900,000 on the same date.
- Balances are as given below:

Profit and loss account		
Storm Ltd.	1 October 2001	Sh. 500,000 (debit).
	1 October 2002	Sh. 600,000 (debit).
Thunder Ltd.	1 October 2002	Sh. 300,000 (debit).
General reserve		
Storm Ltd.	1 October 2001	Sh. 1,000,000
	1 October 2002	Sh. 2,000,000
Thunder Ltd.	1 October 2002	-

- The following inter-company balance are included in the balances of trade debtors and trade creditors:

Receivables	Rain Ltd.	Sh. 600,000 due from Thunder Ltd.
	Thunder Ltd.	Sh. 300,000 due from Rain Ltd.
		Sh. 200,000 due from Thunder Ltd.

- On 30 September 2003, thunder Ltd. remitted Sh.200,00 to Rain Ltd. which was not received until 3 October. There were no other inter-company balances.
- Rain Ltd. sold goods to Storm Ltd. for Sh.800,000. The goods had originally cost Rain Ltd. Sh.600,000. Storm Ltd. still had Sh.200,000 worth of these goods (at invoiced price) in stock as at 30 September, 2003.

Required:

Prepare the consolidated statement of financial position of Rain Ltd. and its subsidiaries as at 30 September 2003.

Solution:**Rain Ltd and its subsidiaries****Consolidated Statement of financial position as at 30 September 2003**

	Sh.'000'	Sh.'000'
<u>Non Current Assets</u>		
PPE		22,000
Goodwill (W2)		<u>1,006</u>
		23,006
<u>Current Assets</u>		
Inventory (2 + 1.2 + 1.6 – 0.05)	4,750	
Receivables(W6)	6,500	
Cash (2.7 + 1.4 + 1.14 + 0.2)	<u>5,400</u>	
		<u>16650</u>
		<u>39656</u>
<u>EQUITY AND LIABILITIES</u>		
Share capital		15,000
Sh.100 ordinary shares fully paid		7,780
General reserve (W5)		<u>2,328</u>
Retained Profits (W4) (300 + 2,028)		25,108
		<u>6,048</u>
Minority interest (W3)		31,156
		8500
<u>Current liabilities:</u>		
Payables		
TOTAL EQUITY AND LIABILITIES		<u>39,656</u>

Workings

1.	Determination of group ownership structure			Thunder Ltd
	Storm Ltd		Ordinary	
	Ordinary	Preference		
Rain Ltd:				
Direct	60%	1/6		25%
Indirect			(60% x 55%)	<u>33%</u>
				<u>58%</u>
Minority Interest	40%	5/6		<u>42%</u>

2. **Cost of Control**

	Sh.'000'		Sh.'000'
Investment in Storm:		Share of Storm equity	
Ordinary	3,400	Ordinary share capital (60% x 5000)	3,400
Preference	600	General reserves (60% x 1000)	600
Share of retained losses (60% x 500)	<u>300</u>	Preference share capital (1/6x3,000)	500
	<u>4,300</u>	Goodwill I	<u>200</u>
Investment in Thunder (60% x 1,900) by Storm	1,140	Share of Thunder equity	
Rain spent in Thunder	1,000	Ordinary share capital (58% x 2,000)	1,160
	<u>6,440</u>	Profit b/f (58% x 300)	174
		Goodwill II	<u>806</u>
			<u>6,440</u>

Total goodwill on consolidation = 806 + 200 = 1,006

3. **Minority Interest**

	Sh.'000'		Sh.'000'
Cost of shares in Thunder (40% x 1900)	760	Storm Ltd: Equity	
Storm Ltd Profit & Loss (40% x 800)	320	Ordinary share capital (40% x 5000)	2,000
Consolidated statement of financial position	6,048	Preference share capital (5/6 x 3000)	2,500
		General reserve (40% x 3000)	1,200
		Thunder Ltd: Equity	
		Ordinary share capital (42% x 2000)	840
		Preference share capital	-
		General reserve (42% x 1000)	420
		Thunder Ltd Profit & Loss (42% x 400)	<u>158</u>
	<u>7,128</u>		<u>7,128</u>

4. **Group retained Earnings A/c**

	Sh.'000'		Sh.'000'
Rain Ltd		Bal b/d: Rain	2,500
UPCs (200/800 x 200)	50	Cost of control a/c (60% x 500)	300
Bal b/f	800	Minority Interest A/c (40% x 800)	320
Thunder Ltd:		Bal b/d: Thunder	400
Cost of control a/c			
25% x 300	75		
33% x 300	<u>99</u>		
Minority interest (42% x 400)	168		
Consolidated statement of financial position	<u>2,328</u>		
	<u>3,520</u>		<u>3,520</u>

5. **Consolidated General reserve**

	Sh.'000'		Sh.'000'
Storm Ltd: COC (60% x 1000)	600	Bal b/f	
MI (40% x 3000)	1,200	Rain	6,000
Thunder: MI (42% x 1,000)	420	Storm	3,000
Consolidated statement of financial position	<u>7,780</u>	Thunder	<u>1,000</u>
	<u>10,000</u>		<u>10,000</u>

Group Receivables A/c			
	Sh.'000'		Sh.'000'
Rain Ltd	4,800	Cash in transit (Thunder)	200
Storm Ltd	2,000	Group creditors: T – R	400
Thunder Ltd	800	R – S	300
		T – S	200
	<u> </u>	To consolidated statement of financial position	<u>6,500</u>
	<u>7,600</u>		<u>7,600</u>
Group Payables A/c			
	Sh.'000'		Sh.'000'
Group debtors	900	Rain Ltd	5,000
To consolidated statement of financial position	8,500	Storm Ltd	2,600
	<u> </u>	Thunder Ltd	<u>1,800</u>
	<u>9,400</u>		<u>9,400</u>

CONSOLIDATED INCOME STATEMENT AND CONSOLIDATED STATEMENT OF CHANGES IN EQUITY.

The consolidated income statement follows similar principles as those of the consolidated statement of financial position. This is because the procedure involves adding the transactions of the subsidiary company to those of the holding company while excluding inter company transactions and making the necessary inter-group adjustments for items like unrealized profits on inventory.

The consolidated statement of changes in equity only reports transactions that are attributable to the holding company. Therefore, it deals with the holding company's retained profits plus the holding company's share of post acquisition retained profits in subsidiary company. The formats are given as follows;

H Ltd and its Subsidiary

Consolidated income statement for the year ended 31 December

	£	£
Revenue		X
Cost of Sales		(x)
Gross Profit		x
Other incomes		x
Distirbution costs	(X)	
Administration expenses	(X)	
Other expenses	(X)	
Finance costs	(x)	(x)
Profit before tax		X
Income tax expense		(x)
Profit for the period		<u>x</u>
Profit attributable to Holding company		x
Profit attributable to Minority Interest		<u>x</u>

Consolidated statement of changes in equity (only the retained profits section)

	£	£
Balance as at 1.1 .2004		<u>X</u>
Profit attributable to the holding company		<u>X</u>
		X
Dividends: Interim Paid	X	
Final Proposed	X	(X)
Balance as at 31.12.2004 (the group retained profits to the statement of financial position)		<u>X</u>

If we are not preparing the published consolidated income statement and the consolidated statement of changes in equity then the two reports can be combined and the income statement can be modified as follows from profit before tax:

	£	£
Profit before tax		x
Income tax expense		(x)
Profit after tax		<u>x</u>
Profit attributable to minority interest		(x)
Profit attributable to holding company		x
Less: Interim dividend paid	x	
Final proposed dividend	x	(x)
Retained profits for the year		<u>x</u>
Retained profits b/d		<u>x</u>
Retained profits c/d		<u><u>x</u></u>

NOTE

The figures in the consolidated income statement can be determined as follows:

	Revenue	COS	OI	AE/ OE	FC	TAX
	£	£	£	£	£	£
Figures appearing in the income statement of Holding Co.	x	x	x	x	x	x
Figures appearing in the income statement of Subsidiary Co.	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>
Total Before adjustments	x	x	x	x	x	x
Less:						
- Intercompany sales of goods (deducted at selling price)	(x)	(x)	-	-	-	-
- Intercompany sales of PPE (deduct selling price from revenue) (deduct cost of the PPE from COS)	(x)	-	-	-	-	-
	-	(x)	-	-	-	-
- Excess annual depreciation due inter company sale of PPE		(x)				
-Intercompany incomes (e.g. dividends & interest from subsidiary)			(x)			
-Intercompany interest paid (e.g. from subsidiary to Holding co.)					(x)	
- Unrealized profit from opening inventory		(x)				
Add:						
-Unrealised profit on closing inventory		x				
-Additonal annual depreciation /amortization due to Fair value adjustment		x				
-Impairment of goodwill (charge for the year)	-	-	-	<u>x</u>	-	-
Final figures to appear in the consolidated income statement	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>	<u>x</u>

Don't worry about the adjustments that need to be made as it will be difficult to get a question that has all these adjustments at once. But they are the probable adjustments that you will come across.

Intercompany sales of goods and PPE should be excluded from the consolidated income statement as these transactions do not involve third parties. Try to recall the treatment of goods sent to the branch and goods received from the head office. These items do not appear in the combined trading profit and loss account. The same approach is used here.

For intercompany sales of goods, we normally deduct the figures at the selling price because what is a selling price to one company is a purchase price to the other company. For sale of property, plant and equipment we should deduct the selling price from revenue and the cost from cost of sales. This is because the selling company may be dealing with the PPE and as such it has included both selling price in its Revenue and the cost of the PPE in the Cost of Sales. However if the selling company has only reported a profit on sale and included in other incomes, then we deduct this from the groups other incomes.

Adjustments for unrealised profit on opening and closing inventory are also important. We normally deduct the unrealised profit on opening inventory from the cost of sales because the cost of sales of one of the company is overstated (this is because the opening inventory is overstated and hence the cost of sales). For unrealised profit on closing inventory we add to cost of sales as the closing inventory is overstated and this lead to an understatement of the cost of sales.

MINORITY INTEREST

The minority interest ideally is entitled to the profit after tax in minority interest. However due to consolidation, the profits of the subsidiary company should be adjusted first before getting their share. Care should also be taken especially if the subsidiary company has issued preference share capital and the minority interest owns part of this.

The computation will therefore be carried out as follows:

	£	£
Subsidiary company's profit after tax		X
Add:		
Annual excess depreciation charged by subsidiary co	X	
Unrealised profit on opening inventory if subsidiary co. had made the sale	x	X
		x
Less		
Annual additional depreciation on Fair value adjustment	X	
Unrealised profit on closing inventory if subsidiary co. made the sale	X	
Unrealised profit on PPE if subsidiary company made the sale	X	(x)
Adjusted profit after tax in subsidiary		X
Less Preference dividend		(x)
Profit attributable to ordinary share holders in subsidiary company		<u>X</u>
Total due to Minority interest:		
- MI's share of preference dividend		X
- MI's share of profit attributable to ordinary shareholders		<u>X</u>
		<u>X</u>

DIVIDENDS

The dividends that appear in the consolidated statement of change in equity are for the holding company only. This is because the dividends of the subsidiary belong to the holding company and minority interest. By consolidating the subsidiary company, the holding company has taken its share of the dividends in subsidiary and the M.I has taken its share which is included in the minority interest's share of profit after tax in subsidiary company.

RETAINED PROFITS BROUGHT FORWARD

If we recall from the consolidated statement of financial position, the group-retained profits should be made up of the holding companies retained profit plus the holding company's share of subsidiary companies post acquisition retained profits. The same case applies to computing the retained profits brought forward of the group. The group-retained profits brought forward should be made up of the holding companies retained profit brought forward plus the holding company's share of subsidiary companies post acquisition retained profits brought forward.

But we have to make adjustments to the holding companies retained profits brought forward and the subsidiary company's profits before we get the holding companies share. The adjustments are for transactions that took place previously that affect the profits of these two companies.

The holding companies retained profits brought forward will therefore be adjusted as follows:

	£	£
Holding companies retained profit brought forward		X
Add: Excess depreciation charged by holding company up to start of the year		<u>X</u>
		x
Less : Unrealised profit on opening inventory if holding company had made the sale	x	
Goodwill impaired to date (up to the start of the year)	x	
Unrealised profit on sale of PPE in previous years if holding co. made the sale	x	(x)
Holding companies retained profit b/f adjusted for consolidation		<u>x</u>

The subsidiaries profits brought forward will be adjusted as follows before the holding company takes its share:

	£	£
Subsidiary companies retained profit brought forward		X
Add: Excess depreciation charged by subsidiary company up to start of the year		<u>X</u>
		x
Less : Unrealised profit on opening inventory if subsidiary company had made the sale	x	
Depreciation on Fair value adjustment that should have been charged to date	x	
Unrealised profit on sale of PPE in previous years if holding co. made the sale	x	(x)
Subsidiary company's retained profit b/f		<u>x</u>

Example

H Ltd acquired 75% of the ordinary shares of S Ltd since S Ltd was incorporated. The Summarized income statement for the two companies for the year ending 31 December

20X2 is as follows:

	H Ltd £	S Ltd £
Sales revenue	75,000.00	38,000.00
Cost of sales	(30,000.00)	(20,000.00)
Gross profit	45,000.00	18,000.00
Operating expenses	(14,000.00)	(8,000.00)
Profit before tax	31,000.00	10,000.00
Taxation	(10,000.00)	(2,000.00)
Profit after tax	21,000.00	8,000.00
Retained profit b/f	87,000.00	17,000.00
Retained profit c/f	108,000.00	25,000.00

Required:

Prepare the consolidated income statement for the year ended 31 December 20X2.

H Ltd. And Its Subsidiary

Consolidated Income Statement for year ended 31/12/2002

	£ '000'	£ '000'
Revenue(75+38)		113
Cost of sales(30+20)		(50)
Gross profit		63
Operating expenses(14+8)		22
Profit before tax		41
Income tax expense(10+2)		(12)
Profit after tax		29
Profit attributable to minority interest		(2)
Profit attributable to holding company		27
Retained profits b/f		99.75
Retained profit b/f		126.75

Example

The share capital of S Ltd is made up of the following items:

	£
10,000 6% 1 preference shares	10,000.00
10,000 1 ordinary shares	10,000.00
	<u>20,000.00</u>

On 1 January 20X0, H Ltd acquired 3,000 preference shares and 7,500 ordinary shares when the retained profits of S Ltd amounted to £4,000. The cost of investment at the date of acquisition was £15,000. Goodwill arising on consolidation is amortized over a period of 5 years.

The following income statements relate to the two companies for the year ended 31 December

20X1.

	H Ltd	S Ltd
	£	£
Sales	200,000.00	98,000.00
Cost of Sales	(90,000.00)	(40,000.00)
Gross Profit	110,000.00	58,000.00
Operating expenses	(35,000.00)	(19,000.00)
Profit before tax	75,000.00	39,000.00
Taxation	(23,000.00)	(18,000.00)
Profit after tax	52,000.00	21,000.00
Dividends		
	Preference	(600.00)
	Ordinary	(2,000.00)
Retained profits for the year	38,000.00	18,400.00
Retained profits b/f	79,000.00	23,000.00
Retained profits c/f	117,000.00	41,400.00

Additional information.

- 1) During the year ended 31.12.20X1 H Ltd sold an item of plant to S Ltd. The plant cost H Ltd £15,000 and H Ltd reported a profit of £5,000 on the sale. This transaction is included in the sales and cost of sales of H Ltd. It is the policy of the group to charge depreciation of 20% on cost for plant.
- 2) During the year S Ltd sold some goods amounting to £20,000 (cost to S Ltd). S Ltd reported profit of 20% on cost. Half of these goods are still in the inventory of H Ltd.
- 3) H Ltd has not yet accounted for its share of the proposed dividends in S Ltd.

Required:

Prepare the consolidated income statement for the year ended 31 December 20X1.

H Ltd. And Its subsidiary**Consolidated income statement for year ended 31/12/20x1**

	£ '000'	£ '000'
Sales		254
Cost of sales		(92)
Gross profit		162
Operating expenses		(54.3)
Profit before tax		107.7
Income tax expense		(41)
Profit after tax		66.7
Profit attributable to minority interest		(5.27)
Profit attributable to holding company		61.43
Less: dividends		(14)
Retained profits for the year		49.43
Retained profits b/d		22.95
Retained profits c/d		140.38

Workings:

(i) Items to income statement

	Revenue £ '000'	COS £ '000'	Expenses £ '000'	Tax £ '000'
H Ltd	200	90	35	23
S Ltd	98	40	19	18
	298	130	54	41
Less Intercompany sales : PPE	(20)	(15)		
Goods	(24)	(20)		
Excess depreciation		(1)		
Add: Unraised profit on closing inventory		2		
Goodwill impaired			0.3	
To consolidated income statement	254	92	54.3	41

(iii) Minority Interest

	£ '000'
Subsidiary company's profit after tax	21
Add:	
Annual excess depreciation charged by S Ltd	1
	22
Less	
Unrealised profit on closing inventory S Ltd made the sale	(2)
Adjusted profit after tax in subsidiary	20
Less Preference dividend	<u>(0.6)</u>
Profit attributable to ordinary share holders in S Ltd	<u>19.4</u>
Total due to Minority interest:	
- MP's share of preference dividend (70% X 0.6)	0.42
- MP's share of profit attributable to ordinary shareholders (25% X 19.4)	<u>4.85</u>
	<u>5.27</u>

(iv) Retained profit b/f

	£ '000'	£ '000'
Holding company's retained profit b/d		79
Less: Goodwill impaired in previous year		<u>(0.3)</u>
		78.7
Add: Share in S Ltd		
Retained profit b/f in S Ltd	23	
Less pre acquisition profits	<u>(4)</u>	
Post acquisition profits	19	
Share of H Ltd (75% X 19)		<u>14.25</u>
		<u>92.95</u>

ACQUISITION OF A SUBSIDIARY COMPANY DURING THE YEAR.

When the holding company acquires a subsidiary company portray during the financial period, then the approach to preparing the consolidated income statement will change slightly. This is because IAS 27 requires that the subsidiary company should be consolidated from the date of acquisition.

This means that the results of the subsidiary company should be assumed to accrue evenly over the year and thus they can be split between pre-acquisition and post-acquisition period.

Thereafter the post-acquisition results are consolidated the normal way, paying attention to the following items.

- i) The sales, cost of sales, expenses and tax of the subsidiary company that relate to the post-acquisition period will be added to those of the holding company while making adjustments for inter-company items that have arisen or that relate to the post-acquisition period.
e.g.; Inter-company sales should relate to the post acquisition period, goodwill impaired should be pro-rated and same case applies for additional **depreciation** on fair value adjustments.
- ii) The computation of the minority interest will remain as before only that this time we will take the post acquisition profits after tax of the subsidiary company.

NOTE: In the adjustments, there will be no unrealised profit on opening inventory on opening inventory.

- iii) The group retained profits b/f will only be for the holding company. this is simply because the retained profits b/f of subsidiary company are all pre-acquisition.

NOTE: In computing goodwill, do not forget pre-acquisition dividend..

Example;

H Ltd acquired 60% of the ordinary share capital of S Ltd on 1.4.20X2. The income statements of the two companies for the year ended 31.12.20X2 are as follows:

	H Ltd	S Ltd
	£	£
Turnover	170,000.00	80,000.00
Cost of Sales	(65,000.00)	(36,000.00)
Gross profit	105,000.00	44,000.00
Operating expenses	(43,000.00)	(12,000.00)
Profit before tax	62,000.00	32,000.00
Taxation	(23,000.00)	(8,000.00)
Profit after tax	39,000.00	24,000.00
Dividends proposed	(12,000.00)	(6,000.00)
Retained profits for the year	27,000.00	18,000.00
Retained profits b/f	81,000.00	40,000.00
Retained profits c/f	108,000.00	58,000.00

H Ltd has not accounted for its share of proposed dividends in S Ltd. The profits of S Ltd accrued evenly through out the period.

Required:

Prepare the consolidated income statement for the year ended 31.12.20X2.

Solution

H Ltd. and Its Subsidiary

Consolidated income statement for the year 31/12 20x2

	£
Revenue	230,000
Cost of sales	<u>(92,000)</u>
GROSS PROFIT	138,000
Operating expenses	<u>(52,000)</u>
Profit before tax	86,000
Income tax expense	<u>(29,000)</u>
Profit after tax	57,000
Profit attributable to Minority interest	<u>(7,200)</u>
Profit attributable to holding company	49,800
Less: dividends (only for H)	<u>(12,000)</u>
Retained profits for the year	37,800
Retained profits b/f (only for H)	<u>81,000</u>
Retained profits c/d	<u>118,800</u>

Example(June 1997 Q1)

Mtito Limited purchased 80% of the ordinary shares of Andei Limited on 1 May 1996. On 30 September 1996, the trial balances of the two companies were as follows:

	Mtito Ltd. Sh.'000	Andei Ltd. Sh.'000'
Cash at bank		11,500
Debtors	62,300	51,600
Dividend: Interim paid	4,500	3,000
Expenses (including depreciation of fixed assets)	184,700	123,600
Freehold land and buildings (net book value)	25,500	18,900
Investment in Andei Limited	94,260	
Motor vehicles (net book value)	6,700	4,900
Purchases	375,400	335,200
Plant and machinery (net book value)	28,900	21,600
Stock	22,100	17,600
Taxation: instalment tax paid	9,100	6 380
	813460	594280
Bank overdraft (secured on land and buildings)	6,700	
Creditors	38,200	17,100
Sales	586,600	480,000
Share capital: Authorised, issued and fully paid Ordinary shares of Sh. 10	60,000	20,000
Profit and loss account	121960	77,180
	<u>813460</u>	<u>594280</u>

Additional information:

1. Closing stock was Sh.24,200,000 in Mtito and Sh.19,200,000 in Andei.
2. The turnover and expenses in Andei accrued evenly over the year; the rate of gross profit was constant throughout the year.
3. Mtito paid its interim dividend on 15 May 1996; Andei paid its interim dividend on 31 March 1996. Mtito has not yet accounted for any dividend receivable from Andei.
4. Between 1 May 1996 and 30 September 1996, Mtito sold goods to Andei. These goods had cost Mtito Sh.30 million. Mtito earned a gross profit of 37.5% on the selling price of these goods. At 30 September 1996, one sixth of these goods were included in the stock of Andei. Included in the debtors figure for Mtito was Sh.7,200,000 from Andei: Mtito's account in Andei's books agreed with this figure.
5. The self assessment tax returns of Mtito and Andei show the corporation tax charge for the year at Sh. 10,020,000 and Sh.7,980,000 respectively; both companies have paid instalment tax on the preceding year basis.
6. The directors have proposed that Mtito should pay a final dividend of Sh.6 million and Andei Sh.3 million.
7. Mtito's accounting policy with regard to goodwill is to carry it as an asset and amortise it over 60 months, on a straight line basis. Mtito removes the whole amount of any unrealised profit on closing stock from the stock and from the company which made the profit, in the latter case adjusting the minority interest, if appropriate. Mtito incorporates the results of operations of Andei as from the date of acquisition, and carries any dividends to minority interests as a current liability.

Required:

A consolidated income statement for the year ended 30 September 1996 (including reconciliations of the retained profit for the year and carried forward) and a consolidated statement of financial position as at 30 September 1996.

(25 marks)**Solution**

Note: This is a challenging question due to the fact that you have to prepare consolidated final accounts from the trial balances. The first step as part of your workings will be to prepare the draft income statements for both the holding company and the subsidiary company.

Mtito and its Subsidiary**Consolidated income statement for the year 30/9/1996**

	Sh. '000'	Sh. '000
Revenue		738,600
Cost of sale		<u>467,300</u>
GROSS PROFIT		271,300
Expenses		<u>(237,200)</u>
Profit before tax		34,100
Income tax expense		<u>(13,345)</u>
Profit after tax		20,755
Profit attr. to minority interest (20% \times 5/12 \times 14,820)		<u>(1,235)</u>
Profit attributable to holding company		19,520
Less dividends : Interim paid	4,500	
Fund proposed	<u>6,000</u>	<u>(10,500)</u>
Retained profit for year		9,020
Retained profit for b/d		<u>121,960</u>
Retained profit for c/d		<u>130,980</u>

Statement of retained profits

	B/d	For the year	C/d
	Sh. '000'	Sh. '000'	Sh. '000'
H Ltd. Profits	121,960	6,080	128,040
Share in Andei Ltd.	<u>-</u>	<u>2,940</u>	<u>2,940</u>
Group	121,960	9,020	130,980
Workings for H Ltd.			
As per the accounts	121,960	8,080	130,040
Add: dividends receivable from A		2,400	2,400
Less: Pre-acquisition dividends to C.O.C		(400)	(400)
Less: UP on closing inventory		(3,000)	(3,000)
Goods impaired	<u>-</u>	<u>(1,000)</u>	<u>(1,000)</u>
	121,960	6,080	128,040
Workings for share in Andei			
As per the accounts	77,180	8,820	86,000
Less: pre-acquisition profits	<u>(77,180)</u>	<u>(5,145)</u>	<u>(82,235)</u>
Pre-acquisition retained profits	<u>-</u>	<u>3,675</u>	<u>3,675</u>
Share of Mito @ 80%	-	2,940	2,940

Mito and its Subsidiary**Consolidated Statement of financial position as at 30/9/1996**

	Sh. '000'	Sh. '000'
NON-CURRENT ASSETS		
Freehold land and buildings		44,400
Plant and machinery		50,500
Motor vehicles		11,600
Goodwill		<u>11,000</u>
		117,500
CURRENT ASSETS		
Inventory (total less unrealized profit)	40,400	
Debtors (total less intercompany balance)	106,700	
Cash at bank	<u>11,500</u>	<u>158,600</u>
		<u>276,100</u>
Ordinary share capital		60,000
Retained profits c/d		130,980
		190,980
Minority interest (20% X (20,000+86,000))		<u>21,200</u>
Shareholders funds		212,180

CURRENT LIABILITIES

Bank overdraft	6,700	
Creditors (total less intercompany balance)	48,100	
Current tax liability	2,520	
Proposed dividends (6000 + (20%X3,000))	<u>6,600</u>	<u>63,920</u>
		<u>276,100</u>

Workings:

1. Draft income statements

	MTITO	ANDEI
	Sh. '000'	Sh. '000'
Sales	586,600	480,000
Cost of sales	<u>(373,300)</u>	<u>(333,600)</u>
GROSS PROFIT	213,300	146,400
Expenses	<u>(184,700)</u>	<u>(123,600)</u>
Profit before tax	28,600	22,800
Income tax expense	<u>(10,020)</u>	<u>(7,980)</u>
Profit after tax	18,580	14,820
Dividends interim paid	(4,500)	(3,000)
Final proposed	<u>(6,000)</u>	<u>(3,000)</u>
Retained profit for year	8,080	8,820
Retained profit b/d	<u>121,960</u>	<u>77,180</u>
Retained profit c/d	<u>130,040</u>	<u>86,000</u>

2 Items in the income statement (figures in sh000)

	Revenue	COS	Expenses	Tax
Mtito Ltd	586,000	373,300	184,700	10,020
Andei Ltd (Only for five months)	<u>200,000</u>	<u>139,000</u>	<u>51,500</u>	<u>3,325</u>
Total before adjustments	786,000	512,300	236,200	13,345
Less: Intercompany sale of goods	(48,000)	(48,000)		
Add: Unrealised profit on closing inventory (1/6X 18m)		3,000		
Add: Goodwill impaired			1000	
To Consolidated income statement	<u>738,600</u>	<u>467,300</u>	<u>237,200</u>	<u>13,345</u>

Goodwill impaired

Note: we assume that goodwill has been impaired at the rate of 8.3333% i.e 5 out six months

Cost of control account

	Sh. '000'			Sh. '000'
Investment in A	94,260	OSC (80% x 20,000)		16,000
		P & L (80% x 82,325)		65,860
		Pre-acquisition dividend		400
		Goodwill impairment		1,000
		Balance c/d (b/s)		<u>11,000</u>
	<u>94,260</u>			<u>94,260</u>

Profits on date of acquisition:

Retained profits for the year in subsidiary: 8,820

Pre-acquisition profits ; 1st May 1996 – 30st September 1996 = $\frac{7}{12} \times 8,820 = 5,145$

Retained profits on acquisition = bal b/d + pre-acquisition
 = 77,180 + 5,145
 = sh82,325,000

Pre acquisition dividends

		sh000
Total dividends by A	: Paid	3,000
	Proposed	<u>3,000</u>
		<u>6,000</u>
Post acquisition dividends	(5/12 x 6,000)	2,500
Pre-acquisition dividend to cost of control		
Holding company share of dividend:		
	Interim receive (did not receive)	0
	Interim proposed (80/100x 3,000)	<u>2,400</u>
		2,400
Less: Holding company share of post acquisition of dividends	(80/100 x 2,500)	<u>2,000</u>
		<u>400</u>

Circumstances under which a subsidiary company can be excluded from consolidation

Consolidated financial statements shall include all subsidiaries of the parent

A parent need not present consolidated financial statements if and only if;

- (a) The parent is itself a wholly owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.
- (b) The parent's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).
- (c) The parent did not file, nor is it in the process of filing, its financial statements with securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market.

- (d) The ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with international financial reporting standards.

Note:

- The standard does not require consolidation of a subsidiary acquired when there is evidence that the control is intended to be temporary. However there must be evidence that the subsidiary is acquired with the intention to dispose of it within twelve months and that management is actively seeking a buyer. When a subsidiary previously excluded from consolidated is not disposed of within twelve months it must be consolidated as from the date of acquisition unless narrowly specified circumstances apply.
- An entity is not permitted to exclude from consolidated an entity it continues to control simply because that entity is operating under severe long-term restrictions that significantly impair its ability to transfer funds to the parent. Control must be lost for exclusion to occur.
- A subsidiary is not excluded from consolidated simply because the investor is a venture capital organization, mutual fund, unit trust or similar entity.
- A subsidiary is not excluded from consolidated because its business activities are dissimilar from those of the other entities within the group. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosure required by IAS 14 (segment reporting) help to explain the significance of different business activities within the group.

Some of the reasons for exclusion are given under the companies Act but are now prohibited by the standard.

ASSOCIATE COMPANIES (IAS 28)

An associate company is a company in which the investing company owns more than 20% but less than 50% of the voting rights. This means that the investing company does not control or own the associate company but has a participating influence in the financial and operating activities of the associate company.

The participating influence arises because the investing company virtue of its significant voting rights can be able to appoint one or two directors in the board of directors of the associate company. These directors will take part in the decision making process.

As the investing company doesn't control the associate company, associate company are therefore NOT consolidated. However, due to the participating influence, they cannot be treated as mere investments and thus IAS 28 requires the use of equity method of accounting.

In summary, the equity method of accounting requires that the investment in associate company should initially be carried in the accounts at cost and thereafter the amount increased with the investing company's share of post-acquisition retained profits in the associate company.

In preparing the final accounts the following approach will be used;

INCOME STATEMENT

- a) Ignore the sales, cost of sales and the expenses of the associate company. However, premium or goodwill arising on acquisition of associate company should be computed the normal way as that of the subsidiary company incase of any impairment, then it should be included in the investing company's expenses..
- b) The investing company should report its share of profit before tax in associate company as part of other incomes and its hare of tax in associate company as part of its income tax expense.
Alternatively, the investing company can show its share of profit after tax in associate company as other incomes..

- c) Just like in subsidiary companies the retained profits b/d of the investing company will be made up of the investing company's retained profits b/d of the associate company.
Adjustments for previously impaired goodwill or premium should be made at this stage.

STATEMENT OF FINANCIAL POSITION

In the statement of financial position, the assets and liabilities of the associate company will be ignored but instead the investment in associate company will be shown as part of the non-current assets. The amount to appear in the statement of financial position can be computed in the following two ways;

	£
Cost of investment in associate company	x
Add; Investing company share of post-acquisition retained profits in associate company	x
	x
Less: Premium (goodwill) in associate company impaired to date	(x)
	x

NOTE

The premium or goodwill in associate company is used in computing investment in associate company that appears in the statement of financial position and should therefore not be shown as a separate item in the investing company's statement of financial position.

That means that if the investing company has a subsidiary company, it is only the goodwill of the subsidiary company that should appear in the consolidated statement of financial position.

INTER-COMPANY TRANSACTIONS AND BALANCES

As the associate company is not consolidated, care should be taken when there are trading transactions and inter-company balances between the investing company and associate company.
The following general approaches should apply;

- a) **Inter-company sales of inventory and PPE** should be ignored and not adjusted for.
- b) In case of **unrealized profit on PPE, opening and closing inventories and excess depreciation**, then the investing company's share of these items is not deducted from the group retained profits and also from the investment in associate company appearing in the statement of financial position.
If the sale took place in the current year, then the Unrealised profit on PPE and on closing inventory and excess depreciation are deducted from the investing company share of profit before tax in associate company.

However, if the sale took place in previous financial periods, then the UP on PPE, UP on opening inventory and excess depreciation are deducted from the group retained profits b/d.

NOTE ; The accounting treatment is the same irrespective of the company that made the sale.

- c) **In the case of inter-company balances**, the amount due to or from the associate company will still appear in the final statement of financial position as they are not supposed to be cancelled out.

However you may present the amounts due to or from associate company as a separate item from the other receivables or payables.

For example.

In the consolidated statement of financial position, the final statement of financial position of the investing company, below the receivables will have; due from associate company which is made up of the balance due from associate company as a debtor plus the investing company share of the proposed dividends in the associate company.

Example (June 1999)

Amua Limited purchased 80% of the ordinary share capital of Sawana Limited on 31 January 1999 for Sh.496 million and 20% of the ordinary share capital of Ukwala Limited on 31 July 1998 for Sh.56 million. Profits in all companies are deemed to accrue evenly over the year.

The draft accounts for the three companies are shown below:

Statement of financial position as at 30 April 1999				Profit and loss accounts for the year ended 30 April 1999			
	Amua Ltd	Sawana Ltd	Ukwala Ltd		Amua Ltd	Sawana Ltd	Ukwala Ltd
	Sh	Sh	Sh.		Sh	Sh	Sh.
	.million	.million	million		.million	.million	Million
Fixed assets (NBV)	414	280	220	Sales	2,346	2,400	1,400
Investments	<u>552</u>	-	-	Cost of sales	<u>(1,564)</u>	<u>(1,620)</u>	<u>(840)</u>
	966	280	220	Gross profit	782	780	560
Current assets				Distribution costs	<u>(310)</u>	<u>(400)</u>	<u>(200)</u>
Stock	180	210	70	Admin expenses	<u>(240)</u>	<u>(200)</u>	<u>(180)</u>
Debtors	240	140	56	Profit from operations	232	180	180
Bank	<u>28</u>	<u>12</u>	<u>21</u>	Interest on debentures	<u>(42)</u>	=	=
	448	362	147	Profit before tax	190	180	180
Current Liabilities				Taxation	<u>(72)</u>	<u>(40)</u>	<u>(20)</u>
Creditors	189	109	45	Profit after tax	118	140	160
Tax	7	3	2	Dividends proposed	<u>63</u>	<u>40</u>	<u>40</u>
Proposed dividends	<u>63</u>	<u>40</u>	<u>40</u>	Retained profits			
	259	152	87	For the year	55	100	120
Net current assets	<u>189</u>	<u>210</u>	<u>60</u>	Brought forward	<u>120</u>	<u>190</u>	<u>(40)</u>
	<u>1,155</u>	<u>490</u>	<u>280</u>	Carried forward	<u>175</u>	<u>290</u>	<u>80</u>
Share capital ordinary							
Shares of Sh.10 each	700	200	200				
Retained earnings	175	<u>290</u>	<u>80</u>				
Shareholders' Funds	875	<u>490</u>	<u>280</u>				
15% Debentures	280						
	<u>1,155</u>						

Additional information

1. Amua Limited has not yet accounted for dividends receivable from either its subsidiary or its associated company.
2. Assume that goodwill and premium has been impaired at the rate of 20% per annum.. The fair value of the identifiable net assets in the subsidiary, at the time Amua Ltd. acquired its shareholding, are equal to book values. Amua Limited carries dividends due to minority interests as a current liability.

Required:

The consolidated income statement (which should be in accordance with the International Accounting Standard No. 1, showing expenses by function on the face of the profit and loss account) for the year ended 30 April 1999, and the Consolidated statement of financial position as at that date.

Do not produce a statement of changes in equity for the year: the retained profit brought forward and carried forward should be included instead in the profit and loss account. Account for the associated company in accordance with the equity method as laid down in IAS 28.

Solution

Amua Ltd. And to be subsidiary
Consolidated income statement for the year ended 30 April 1999.

	Sh. Million	Sh. Million
Revenue (2346 + 2400 x 3/12)		2946
Cost of sales (1564 + 3/12 x 1620)		<u>(1969)</u>
GROSS PROFIT		977
Other incomes		
Share of profit before tax in Ukwala (20% x 180) x 9/12		<u>27</u>
Expenses		1,004
Distribution costs (310 + 3/12 x 400)	410	
Administration cost (240 + 3/12 x 200 + 7.4)	297.4	
Finance costs	<u>42</u>	<u>(749.4)</u>
Profit before tax		254.6
Income tax expense [72 + (3/12 x 40) + (20% x 20 x 9/12)]		<u>(85)</u>
Profit after tax for the period		<u>169.6</u>
Attributable to Holding company		162.6
Minority interest (20% x 3/12 x 140)		<u>7</u>
		169.6

Consolidated statement of changes in equity (extract)

	Sh million (retained profits)
Balance as at 1 May 1998	120
Profit for the period	162.6
	282.6
Dividends proposed (of holding company)	(63)
Balance as at 30 April 1999	219.6

Workings:	Sh. M
Goodwill/Premium impaired	
Goodwill impaired in Sakana	5
Premium impaired in Ukwala	2.4
	7.4

Cost of control account - S

	Sh. M		Sh. M
Investment in S	496	OSC (80% x 200)	160
		P & L (80% x 265)	212
		Pre-acquisition dividend (80% x 9/12 x 40)	24
		Goodwill	
		Impaired P&L (20 x 100 x 3/12)	5
	<u> </u>	Balance c/d b/s	<u>95</u>

496 |496**Cost of control account - U**

	Sh. M		Sh. M
Interest in U	56	OSC (20% x 200)	40
P 7 L (20% x 10)	2	Pre-acquisition dividend (20% x 3/12 x 40)	212
		premium	24
		Impaired P&L (20% x 16 x 9/12)	
	—	Balance c/d (Statement of financial position)	—5
	<u>58</u>		<u>496</u>

Amua Ltd. And Its Subsidiaries**Consolidated Statement of financial position as at 30 April 1999**

	Sh. Million	Sh. Million
NON-CURRENT ASSETS		
Property, plant and equipment		694
Goodwill		95
Investment in associate company		<u>69.6</u>
		858.6
CURRENT ASSETS		
Inventory	390	
Debtors	380	
Due from associate (20% x 40) dividend due	8	
Bank	<u>40</u>	<u>818</u>
		1,676.6
Ordinary share capital		700
Retained earnings		<u>219.6</u>
		919.6
Minority interest		<u>98</u>
Shareholders funds		1,017.6
NON-CURRENT LIABILITIES		
Debentures (15%)		280
CURRENT LIABILITIES		
Creditors	298	
Current tax liability	10	
Proposed dividends	<u>71</u>	<u>379</u>

1,676.6

Investment in associate company

	Sh. M		Sh.m
Cost of investment I associate	56		
Less: Pre-acquisition dividends	<u>(2)</u>		
	54		
Add: Share of post-acquisition profits in U	<u>18</u>		
	72		
Less: Premium amortized to date	<u>(2.4)</u>		
	<u>69.6</u>		
Share of net assets/shareholders funds n U		56	
Add: Premium unimpaired		<u>13.6</u>	
		<u>69.6</u>	

Statement for retained profits (not part of published accounts)

	B/f Sh. M	For the years Sh.M	C/d Sh. M
Amua Ltd.	120	61.6	181.6
Share in Sawana	-	20	20
Share in Ukwala	<u>-</u>	<u>18</u>	<u>18</u>
	<u>120</u>	<u>99.6</u>	<u>219.6</u>
Working in Amua Ltd.			
As per the account	120	55	175
Add: dividends receivable	-	32	32
Less: Pre-acquisition to S		(24)	(24)
Dividend receivable U		8	8
Less: Pre-acquisition		(2)	(2)
Less: Goodwill impaired in S		(5)	(5)
U		<u>(2.4)</u>	<u>(24)</u>
	<u>120</u>	<u>61.1</u>	<u>181.6</u>
Working for share in S			
As per the account	190	100	290
Less: Pre-acquisition	<u>190</u>	<u>(75)</u>	<u>(265)</u>
	<u>-</u>	<u>25</u>	<u>25</u>
Share of annual @80%	<u>-</u>	<u>20</u>	<u>20</u>
Working for share in U			
As per the account	(40)	120	80
Less: pre-acquisition	<u>40</u>	<u>(30)</u>	<u>10</u>
	<u>-</u>	<u>90</u>	<u>90</u>
Share of A @ 20%	<u>-</u>	<u>18</u>	<u>18</u>

If we are to prepare the consolidated statement of financial position with an associate company then, the group retained profits account will be shown as follows:

Group profit and loss account

	Sh. M		Sh. M
C.O.C P & L at acquisition	212	Amua Ltd. (P & L)	175
Minority interest in S (20% x 290)	58	Sawana Ltd. (P & L)	290
Impairment GW	5	Share of post-acquisition in U (20% x 90)	18
Premium	2.4	Post-acquisition dividend S	8
		U	6
Balance c/d	219.6		
	<u>497</u>		<u>497</u>

CONSOLIDATED CASHFLOW STATEMENTS (IAS 7)

The basic cash flow statement has been covered under Financial Accounting II. The following introduction will serve as a quick reminder.

A Cashflow statement is a simple report that explains the various sources of cash and how the business puts this cash into use. The objective of IAS 7 is to recommend the format in which the cashflow statement should be presented and where the various sources of cash and payments should be classified.

The cash received and payments made should be classified into main categories which are:-

1. **Cashflows from operating activities:** operating activities are the principle revenue generating activities of the business and examples of such cashflows include:
 - i) Cash received from customers
 - ii) Cash paid to suppliers of goods and services
 - iii) Cash paid to employees
2. **Cashflows from investing activities:** involving activities involve the acquisition and disposal of non-current assets such as; property, plant and equipment, intangible assets, and long-term investments.

Examples of such cashflows include:

- i) Proceeds on sale of non-current assets e.g. PPE and
 - ii) Cash used on acquisition of non-current assets e.g. PPE
 - iii) Investment income received (not accrued)
3. **Cashflows from financing activities;** Financing activities are those activities that will lead to either an increase or decrease in shareholders funds and long-term liabilities.

Examples of such cashflows include;

- i) Proceeds on issue of shares
- ii) Repayment of loans e.g. loan stock or debentures

- iii) Capital repayment on finance lease
- iv) Dividends paid

IAS 7 recommends that the cashflow statement can be prepared using two methods:-

I) Direct method

Whereby, cash from operations is determined by getting the differences between cash received from customers and cash paid to suppliers of goods and services and employees.

II) Indirect method

The cash from operations is determined by making adjustments to the profit before tax for the following items.

- b) Non-cash income and expenses e.g. depreciation, amortization, loss or profit on disposal of PPE
- c) Incorrectly classified items e.g. investment income and interest charged
- d) Working capital changes.

In addition to the above items, the following points need to be noted about preparation of consolidated cashflow statements.

- i) Goodwill impaired for the year is a non-cash expense that should be added back to the group profit before the tax.
- ii) Where the group has investments in associate company then dividends received from associate should be reported as a separate item under investing activities. The dividend to be reported can be determined as follows.

Investment in associate account

Balance b/d	£ x	Share of tax in associate company	£
Share of profit before tax in associate company		Dividends balance figure	x
		Balance c/d	x
	<u>x</u>		<u>x</u>

The dividends paid to minority interest should also be disclosed separately from those of the holding company and classified under financing activities

Dividends paid to minority interest may be determined as follows:

Minority interest account

Dividends balance figure	£ x	Balance b/d	£
Balance c/d	x	Share of profits in subsidiary	x
	<u>x</u>		<u>x</u>

Example (December 2002)

The voice of the Nation Limited is a Nairobi based media company. Its Consolidated Income Statement for the year ended 30 April 2003, and its Consolidated Statement of financial positions as at 30 April 2002 and 2003 are as follows:

Consolidated Income Statement for the year ended 30 April 2003

	<u>Sh.million</u>
Sales	3,325
Cost of sales	<u>(1,935)</u>
Gross profit	1,390
Distribution costs	(225)
Administrative expenses	<u>(790)</u>
Operating profit	375
Finance costs: Int expense	(8)
Share of results of associate	<u>50</u>
Profit before tax	417
Tax: Group companies	(110)
Share of associate	(15)
Profit before minority interest	<u>292</u>
Minority interest	<u>(28)</u>
Profit after tax	<u><u>264</u></u>

Additional information:

- The holding company, the subsidiary and the associate had all paid dividends during the year.

A class of assets in the subsidiary had been revalued during the year. Depreciation of Sh.20 million had been written back on the revaluation. The transfer to the revaluation surplus account in the subsidiary was Sh.120 million. The minority interest owns 40% of the share capital of the subsidiary.

Property, plant and equipment which had cost Sh.100 million and on which accumulated depreciation stood at Sh.47 million at 30 April 2002 was sold for Sh.70 million in the year.

The group classifies interest paid as an operating cash flow, there were no accruals at the beginning or at the end of the year in respect of this item. It classifies dividends received as an investing activity and any dividends paid as an investing activity. The bank overdraft is classified as a component of each and cash equivalent.

Required:

Prepare the Consolidated Cash flow Statement for the year ended 30 April 2003 for the group using the indirect method. (20 marks)

Consolidated Statement of financial position as at 30 April
Non-current assets:

	2003 Sh.milli on	2002 Sh.million
Property, plant and equip. (Cost or Valuation)	2,297	2,134
Accumulated	(931)	(733)
Depreciation	1,366	1,401
Intangible asset: Goodwill	126	126
Amortisation	(30)	(17)
	96	109
Investment in associate	<u>263</u>	<u>246</u>
	1,725	1,756
Current assets:		
Inventories	276	178
Receivables and prepayments	607	623
	93	71
Cash and cash equivalents	976	872
Current Liabilities:		
Payables and accrued expenses	615	484
	22	16
Current tax	8	133
Borrowings: bank overdraft	<u>645</u>	<u>645</u>
	<u>331</u>	<u>331</u>
Net current assets	<u><u>2,056</u></u>	<u><u>1,940</u></u>
Capital and reserves:		
Share capital	500	500
Revaluation reserve	260	133
Retained earnings	<u>839</u>	<u>725</u>
Shareholders' funds	1,599	1,413
Minority interest	240	204
Non-current liabilities:		
Borrowings: commercial paper	110	200
	107	123
Deferred tax	<u>217</u>	<u>323</u>
	<u><u>2,056</u></u>	<u><u>1,940</u></u>

Solution

Voice of Nations Ltd.

Consolidated cashflow statement for the year ended 30 April 2003

Sh m	Sh. m	
Cashflows from operating activities		
Group profits before tax	417	
Adjustments – cash items		
Depreciation	265	
Amortization of goodwill	13	
Profit on disposal of PPE (70 – (100 – 47))	(17)	
Interest expense	8	
Share of results in associate company	<u>(50)</u>	
	636	
Changes in making capital		
Increase in inventory	(98)	
Decrease in debtors and prepayment	16	
Increase in payables	<u>131</u>	
Cash from operations	685	
Less interest paid	(8)	
Tax paid	<u>(120)</u>	
Net cash received from operating activities		557
Cashflows from investing activities		
Cash proceeds on sale of PPE	70	
Acquisition of PPE	(163)	
Dividends from associate company	<u>18</u>	
Net cash used in investing activities		(75)
Cash flows from financing activities		
Dividends paid – Group	(150)	
Minority interest	(40)	
Repayment of commercial paper	<u>(90)</u>	
Net cash used in financing activities		<u>(280)</u>
Net cash used in financing activities		202
Net increase in cash and cash equivalents b/d		<u>(117)</u>
Cash and cash equivalents c/d		<u>85</u>

NOTE: Cash and cash equivalents

	B/d sh m	C/d Sh. M
Cash and cash equivalents	71	93
Bank overdraft	(188)	(8)
Short term investments	<u>–</u>	<u>–</u>
	<u>(117)</u>	<u>85</u>

Workings

1. Depreciation

Depreciation account

	Sh m		Sh m
PPE – Revaluation	20	Disposal	100
Disposal	47	Profit and loss	265
Balance c/d	931		
	<u>998</u>		<u>998</u>

2. Tax

Tax account

	Sh m		Sh m
Balance c/d	120	Balance b/d – def	123
Balance c/d – def	107	Current tax	16
Current	22	Profit and loss	110
	<u>249</u>		<u>249</u>

3. Acquisition of PPE

PPE cost account

	Sh m		Sh m
Balance b/d	2,134	Disposal	100
Revaluation reserve - gain	120	Depreciation on revaluation	20
Cash book	163	Balance c/d	2,297
	<u>2,417</u>		<u>2,417</u>

4. Dividends from associate company

PPE cost account

	Sh m		Sh m
Balance b/d	246	Share of tax	15
Share of PBT	50	Dividends	18
	<u>296</u>	Balance c/d	263
			<u>296</u>

5. Dividends paid

Group retained profits

	Sh m		Sh m
Dividend balance figure	150	Balance b/d	725
Balance c/d	839	Profit after tax & MI	264
	<u>989</u>		<u>989</u>

6.

Minority interest account

	Sh m		Sh m
Dividend balance figure	40	Balance b/d	204
Balance c/d	240	Revenue reserve	48
	<u>280</u>	Profit after tax	28
			<u>280</u>

REINFORCEMENT QUESTIONS

QUESTION ONE

Loita Limited purchased 60% of the ordinary shares of Leserin Limited on 1 January 1999. On 30 September 1999, the trial balances of the two companies were as follows.

	Loita Ltd. Sh. '000'	Leserin ltd. Sh. '000'	
Profit and loss account	64,950	31,800	
Sales	642,500	372,000	
Share capital	100,000	40,000	
Trade and other payables	31,800	18,100	
Dividend receivable	12,000	-	
20% debenture stock	<u>50,000</u>	<u>-</u>	
	<u>901,250</u>	<u>461,900</u>	
Administrative expenses	94,550	36,400	
Cash at bank	6,830	8,200	
Distribution cost	112,350	64,600	
Dividends paid	20,000	20,000	
Installment tax paid	28,100	22,900	
Interest paid	10,000	-	
Investment in subsidiary (at cost)	62,080	-	
Land and buildings (net book value)	60,200	38,100	
Inventories	51,250	28,240	
Motor vehicles (net book value)	11,270	4,400	
Purchases	320,650	187,500	
Plant and machinery (net book value)	70,450	20,300	
Trade and other receivables	<u>53,520</u>	<u>31,260</u>	
	<u>901,250</u>	<u>461,900</u>	

Additional information:

1. The authorised share capital of both companies had been fully issued and paid up in Sh.10 ordinary shares.
2. The turnover and the expenses in Leserin Limited accrued evenly over the year, and the mark-up on the cost of goods sold was constant throughout the year at 100%. Between 1 January 1999 and 30 September 1999. Leserin limited made sales to Loita Limited of Sh.68 million, earning the usual gross profit. Loita limited did not have any of these goods in hand at 30 September 1999, but owed Leserin Limited Sh.6 million. According to Leserin's books Loita Limited owed Sh.9 million but a cheque for Sh.3 million, posted on 28 September 1999 by Loita Limited was not received by Leserin Limited until 8 October 1999.
3. Both companies paid their interim dividends on 15 April 1999. The directors of Loita Limited have proposed a final dividend of 40% and have required Leserin Limited to propose a final dividend of 50%. These have not yet been accounted for but the directors have instructed you to debit these into income statement (not in the statement of changes in equity and carry the proposed dividends as current liabilities. Dividends proposed payable to minority interests should also be carried as current liabilities.
4. The current tax charge for the year was Sh. 31 million and Sh.25 million for Loita Limited and Leserin Limited respectively. Deferred tax is to be ignored.

5. Closing inventories at cost to each company was Sh.51,300,000 for Loita and Sh.29,740,000 for Leser Limited.
6. Goodwill on consolidation should be carried as an asset and amortised on the straight line basis over 5 years, with the appropriate proportion being amortised for a period of less than one year. The results of operations of the subsidiary should be incorporated into the consolidated income statement with effect from the date of acquisition.

Any unrealised profit on intra-group sales of assets is removed from the group assets and from the company which made the profit, in the latter case adjusting the minority interest, if appropriate. The goodwill amortisation charge should appear as a separate expense in the profit and loss account.

Required:

The consolidated income statement for the year ended 30 September 1999 and the consolidated statement of financial position as at that date in accordance with International Accounting Standards and the Kenya Companies Act.

(Total: 25 marks)

QUESTION TWO

The figures that relate to the Profit and Loss Accounts and to the Statement of Charges in Equity for Addis Limited and as subsidiaries Bunyala Limited and Chania Limited for the year ended 30 November 2000 are as follows:

	Addis Ltd. Sh. '000'	Bunyala Ltd. Sh. '000'	Chania Ltd. Sh. '000'
Sales revenue	84,000	66,000	48,000
Inventory 1 December 1999	(3,824)	(3,757)	(2,822)
Inventory 30 November 2000	4,286	4,124	2,452
Purchases	(50,862)	(49,862)	(38,430)
Distribution cost	(13,440)	(8,050)	(9,600)
Administrative expenses	(8,400)	(3,950)	(6,400)
Taxation: Current	(2,140)	(1,050)	-
Deferred	(1,420)	(300)	2,040
Dividends			
Preference: Interim paid 31 May 2000	-	(450)	-
Final paid 30 November 2000	-	(450)	-
Ordinary: Interim paid 31 August 2000	(3,000)	(500)	-
Final proposed 30 November 2000	(4,500)	(750)	(150)
Dividends received	580	-	-
Retained profit: 1 December 1999	18,300	12,600	9,200
Issued and paid-up share capital:			
Preference share capital	Nil	9,000	Nil
Ordinary share capital	15,000	10,000	3,000

Additional information:

1. Addis Limited acquired 180,000 10% preference shares of Sh.20 each and 800,000 ordinary shares of Sh.10 each on 1 December 1996 when the balance on the income statement of Bunyala Limited was Sh.8,100,000. Goodwill of Sh.2,500,000 had arisen on the purchase of these shares. Addis Limited is amortizing this goodwill over 5 years on the straight line basis.
2. Addis Limited acquired 180,000 ordinary shares of Sh.10 each in Chania Limited on 1 March 2000: the purchase price of these shares was to be fixed once the results for the year ended 30 November 2000 to maintain its trustee status.
3. Bunyala Limited makes sales to Addis Limited at its nominal selling price. In the year ended 30 November 2000, Bunyala Limited's sales to Addis Limited amounted to Sh.9,300,000. Stock purchased from Bunyala Limited and

held by Addis Limited at cost amounted to Sh.540,000 and Sh.720,000 on 30 November 1999 and 30 November 2000 respectively.

4. Addis Limited sold an item of plant to Bunyala Limited on 1 December 1998 for Sh.2,400,000. Addis Limited had marked up its cost by 20%. Bunyala Limited is depreciating this item of plant to nil residual value on the straight line basis over 10 years with the charge appearing as part of cost of sales.
5. There has been no intra-group trade between Chania Limited and other two companies.
6. Group policy in relation to unrealised profit on intra-group sales is of assets as to remove the whole of the unrealised profit from the asset and from the company which made the profit on the sale of the asset adjusting the minority interest's share of this profit as appropriate. The amortization of goodwill is classified as an administrative expense and deemed to be a charge against the profit of the holding company.

Required:

The consolidated Income Statement and the portion of the Consolidated Statement of Charges in Equity that relates to accumulated profit, giving the details required by International Accounting Standard and the Kenya Companies Act, including reconciliation of the group retained profit for the year and carried forward.

(Total: 20 marks)

QUESTION THREE

The statement of financial positions of AC Limited, BEM Limited and CET Limited as at 31 May 2000 were as follows:

	AC Ltd. Sh. '000'	BEM Ltd. Sh. '000'	CET Ltd. Sh. '000'
Fixed assets	68,700	36,200	31,900
Investments in subsidiaries:			
BEM Ltd. (Book value)	75,000		
CET Ltd. (cost)		40,000	
Current assets: Debtors	21,200	8,700	6,900
Cash	-	<u>27,100</u>	<u>16,200</u>
	<u>164,900</u>	<u>112,000</u>	<u>55,000</u>
Share capital:			
Authorized issued and fully paid			
Ordinary shares of Sh.10	100,000	30,000	10,000
Profit and loss account	<u>11,000</u>	<u>54,000</u>	<u>28,000</u>
Shareholders' funds	111,100	84,000	38,000
12% loan stock	<u>30,000</u>	<u>20,000</u>	<u>10,000</u>
	<u>141,100</u>	<u>104,000</u>	<u>48,000</u>
Current liabilities:			
Bank overdraft (secured)	9,300	-	-
Creditors	12,700	6,500	5,800
Taxation	<u>1,800</u>	<u>1,500</u>	<u>1,200</u>
	<u>23,800</u>	<u>8,000</u>	<u>7,000</u>
	<u>164,900</u>	<u>112,000</u>	<u>55,000</u>

Additional information:

1. BEM Limited purchased 800,000 ordinary shares in CET Limited on 1 June 1999 for Sh.36 million and Sh.5 million nominal of the 12% loan stock of CET Limited on the same day for Sh.4 million. CET Limited paid an interim dividend of Sh.5 million on 9 January 2000. The directors have proposed a final dividend of the same amount but this dividend has not been included in the statement of financial position above. The balance on the income statement of CET Limited was Sh.30 million at 1 June 1999. Interest on the 12% loan stock has always been paid up to date.

2. AC Ltd. Purchased 2,250,000 ordinary shares in BEM Ltd. On 1 June 1998 for Sh.70 million. The balance on the income statement of BEM Ltd. On that date was Sh.50 million. On the same day AC Limited purchased Sh.10 million nominal of the 12% loan stock in BEM Limited for Sh.8 million. BEM Limited made a profit after tax of Sh.16 million in the year ended 31 May 2000. BEM Ltd. paid a single dividend of Sh.20 million for the year ended 31 May 1999, which AC Ltd. accounted for appropriately. BEM Ltd. paid an interim dividend of Sh.10 million on 11 February 2000 which AC Ltd. credited to its profit and loss account. A final proposed dividend of Sh.15 million has not yet been reflected in the statement of financial position of BEM Limited above.

When BEM Limited received the dividend from CET Limited on 10 January 2000, BEM Limited credited its profit and loss account: the dividend is included in the Sh.18 million reported by BEM Limited. BEM limited has always paid interest on the 12% loan stock up to date.

3. Goodwill is carried at cost and amortized at 20% per annum on the straight-line basis.
4. The directors of AC limited ask to provide a final dividend of Sh.10 million.

Required:

The consolidated statement of financial position of AC Limited and its subsidiaries as at 31 May 2000.

Note: Proposed dividends should be shown as current liabilities. **(Total: 20 marks)**

QUESTION FOUR

On 1 April 2001 Mega Ltd .acquired 4,500,000 ordinary shares of Ksh.20 par value in Lenga Ltd at a cost of Ksh.152, 000, 000.Further, on 1 July 2001 Mega Ltd acquired 15,000,000 ordinary shares of Ksh 20 par value in Tera Ltd at a cost of Ksh.716, 600,000.Directors were appointed to the boards of both companies by Mega Ltd so as to take an active part in their management. Given below is the information extracted from the books of the companies as at 31 March 2002.

Statement of financial position as at 31 March 2002			
	Mega Sh. '000'	Lenga Sh. '000'	Tera Sh. '000'
Freehold property at cost	720,000	0	200,000
Plant and machinery at cost	1,375,000	450,000	350,000
Inventory	380,000	218,000	360,600
Receivables	374,800,	185,000	125,000
Amount due from Mega Ltd	-	-	48,000
Investments	868000	-	-
Bank balances	-	9,000	40,000
	3,717,800	862,000	1,123,600
Share capital	1,000,000	300,000	400,000
Share premium	200,000	24,000	-
Capital reserve	300,000	-	56,000
Retained profit (as at 31 March 2002)	786000	218,000	288,000
	2,286,000	542,000	744,000
Payables	590,000	110,000	152,000
Amount due to Tera Ltd.	36,000	-	-
Accumulated depreciation –plant and machinery	521,800	120,000	124,600
Current tax	190,000	90,000	103,000

Bank balance	<u>94,000</u>	<u>-</u>	<u>-</u>
	<u>3,717,800</u>	<u>862,000</u>	<u>1,123,600</u>

Additional information is given as follows

- Profit for the year ended 31 March 2002 after tax and before dividends were as follows;

	Sh
Mega Ltd	252,000,000
Lenga Ltd	102,000,000
Tena Ltd	128,000,000

These profits are included in the retained profits.

- No interim dividends were paid in the year but final proposed dividends are as follows;

Mega Ltd	20%
Lenga Ltd	10%
Tera Ltd	10%

- Profits accrued uniformly throughout the year
- Included in the inventory of Mega Ltd. were goods purchased from Tera Ltd. at Sh.40, 000,000. Tera had made profits of 25% on cost of the goods.
- A Remittance of Sh 12,000,000 from Mega Ltd to Tera Ltd at the end of financial year was received in April 2002.
- On 1 April 2001 plant and machinery of Lenga Ltd was revalued upwards by Sh 240,000,000 and the revaluation was not incorporated in the books. Plant and machinery is depreciated at the rate of 10% per annum based on cost.
- Goodwill or premium on consolidation is has been impaired at 20%.

Required

Consolidated statement of financial position of Mega Ltd and its subsidiary as at 31 March 2002 (20 marks)

QUESTION FIVE

The following are the group accounts of Empire Limited and its subsidiary Expansion Ltd. and its associate Broader Ltd.

Consolidated income statement for the year ended 30 June 1998

	Sh.
Group profit before and extra ordinary items	10,950,000
Group taxation	<u>2,250,000</u>
Group profit after tax	8,700,000
Provision for deferred tax	<u>2,700,000</u>
	6,000,000
Deduct minority interest	<u>300,000</u>
	5,700,000
Extra ordinary items (gains)	<u>150,000</u>
	5,850,000
Less ordinary shares dividends	<u>4,650,000</u>
Retained profit for the year	<u>1,200,000</u>

Consolidated statement of financial position as at 30 June

	1998	1997
	Sh. '000'	Sh. '000'
Goodwill	41,250	41,250
Fixed assets	50,850	45,600
Associate (Net assets)	5,850	5,400
Investments	<u>22,350</u>	<u>37,350</u>
Current assets	<u>120,300</u>	<u>129,600</u>
Stocks	49,950	39,450
Debtors	29,850	26,700
Cash at bank	<u>1,200</u>	<u>900</u>
	<u>81,000</u>	<u>67,050</u>
Current liabilities:		
Creditors	33,000	31,650
Dividends	<u>4,650</u>	<u>4,200</u>
	<u>37,650</u>	<u>35,850</u>
Net current assets	<u>43,350</u>	<u>31,200</u>
	<u>163,650</u>	<u>160,800</u>
Financed by:		
Issued share capital	26,400	25,500
Reserves	64,350	73,350
Minority interest	1,500	1,200
Loan capital	38,550	45,750
Short term borrowing	25,050	9,150
Taxation: Deferred tax account	6,600	3,900
Income tax liability	<u>1,200</u>	<u>1,950</u>
	<u>163,650</u>	<u>160,800</u>

The following additional information is provided:

1. Depreciation charge for the year was Sh.3,600
2. Retained profits by:

Subsidiary	Sh. 150,000
Parent	600,000
Associate	<u>450,00</u>
	<u>1,200,000</u>
3. Additions of fixed assets during the year Sh.11,550,000
4. Disposals of fixed assets during the year Sh.2,700,000

Required:

A cash flow statement for the year ended
30 June 1998

(20 marks)

3. Reserves	Share Premium Sh. '000'	Investment Revaluation Sh. '000'	Undistribute d Profits Sh. '000'	Total Sh. '000'
1 May 1997	-	29,550	43,800	73,350
Investment revaluation	-	(11,700)	-	(11,700)
Surplus	-	900	-	900
Retained profits for the year	-	-	1,200	1,200
Premium received	<u>600</u>	<u>-</u>	<u>-</u>	<u>600</u>
	<u>600</u>	<u>18,750</u>	<u>45,000</u>	<u>64,350</u>

4. Additions of fixed assets during the year Sh.11,550,000

5. Disposals of fixed assets during the year Sh.2,700,000

Required:

A cash flow statement for the year ended 30 June 1998

(Total: 20 marks)

CHECK YOUR ANSWERS WITH THOSE GIVEN IN LESSON 9 OF THE STUDY PACK

**COMPREHENSIVE ASSIGNMENT NO. 2
TO BE SUBMITTED AFTER LESSON 4**

To be carried out under examination conditions and sent to the Distance Learning Administrator for marking by the University.

TIME ALLOWED: THREE HOURS.

ANSWER ALL QUESTIONS

QUESTION ONE

Sir Charles' is a fashionable men's clothing store with a Head Office in Mombasa and branches all over Kenya. Books are not maintained in the branches: data is sent by Kenpack Services Ltd. from the branches to a head office computer in Mombasa. A computer program has been developed by Sir Charles' to write up the traditional accounts of each branch in the usual way. The following data relates to the Kisumu branch. All prices quoted are selling prices.

		Sh' 000'
1 July 2003	Opening stock (at Head Office cost plus 50% on cost: goods with a normal selling price of Sh.600,000 had with the authority of the Head Office been marked down by 15%).	6,210
Transactions to		
30 June 2004	Goods received by branch from Head Office (at cost plus 50%)	71,040
	Goods returned to Head Office (including one fifth of the opening stock of marked down goods)	1,470
	Cash sales (these include the remainder of the opening stock of marked down goods and one half of goods received in the year at a selling price of Sh.720,000 marked down by 50% to clear them - the other half is included in closing stock at the year end) - to general public	38,592
	Credit sales (to other retailers)	27,990
	Retailer customer returned goods to Kisumu branch	186
	Goods received from Kisii branch during the year	246
	Goods sent to Kitale branch during the year	321
	Retailer customer returned goods to Head Office in Mombasa	522
	Cash stolen in transit to the bank on 21 June 2004	129
	Goods stolen on the night of 9 March 2005	420

The stock-take carried out on 1 July 2004 confirmed that the book value of closing stock was correct. Kisumu branch expenses amounted to Sh. 19,200,000.

Required:

To test the correctness of the computer program, the chief accountant asks you to write up the Kisumu branch stock account and the Kisumu branch mark-up account, and a memorandum income statement for the year ended 30 June 2004 (15 marks)

QUESTION TWO

Traders Limited operates two branches one in the head office in Nairobi and the other in Busia. Purchases of stock are made exclusively by the head office branch which does some modification to the stocks before they are sold. Goods are sent to the Busia branch at modified cost plus 10% and all sales by both Busia branch and head office branch are made at a gross profit of 25% on the modified goods.

The trial balances as at 30 June 2002 before taking account of the under mentioned adjustments were:

	Nairobi Branch		Busia branch	
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
Capital		1,550		
Purchases	9,847.5			
Cost of modification	252			
Drawings by the owner	275			
Sales		6,400		4,100
Goods sent/received by branch		4,620	4,400	
Selling and general expenses	945		106	
Debtors/Creditors	1,548	3,007	568	54
Branch and head office current accounts	1,949			1,307.5
Bank balances	<u>760</u>		<u>387.5</u>	
	<u>15,577</u>	<u>15,577</u>	<u>5,461.5</u>	<u>5,461.5</u>

Additional information:

1. Goods worth Sh.220,000 sent to Busia branch in June 2002 were not received or recorded by the branch until July 2002 while a remittance of Sh.421,500 from the Busia branch to the head office in June 2002 was not received or recorded at head office until August 2002. Any adjustments in respect of these items are to be made in the head office accounts
2. There was a shortage in stocks of selling value of Sh.100,000 at the Busia Branch. There was no shortage of surplus at the head office.
3. Unmodified goods costing Sh.500,000 were at the Nairobi branch as at 30 June 2002.
4. There was no loss or wastage in the process of modification of stocks by the head office. The branch handles only goods received from the head office.

Required:

Prepare in columnar form for the Nairobi branch, Busia branch and the combined business.

- (a) The income statement for the year ended 30 June 2002 (12 marks)
 - (b) The statement of financial positions as at 30 June 2002. (8 marks)
- (Total: 20 marks).**

QUESTION THREE

Amini Ltd. is a manufacturing business with the head office in Nairobi Kenya, and a branch in Kampala, Uganda. The branch carries out the final assembly of the goods before selling them. The trial balances for both the head office and the branch in their respective currencies as at 31 October were as follows:

	Head office		Branch	
	Sh. "000"	Sh. "000"	Ush. "000"	Ush. "000"
Freehold building at cost	28,000		126,000	
Debtors and creditors	17,800	19,000	72,000	3,120
Sales		208,000		864,000
Shares capital		80,000		
Goods sent to branch		70,000		
Head office/branch account	120,200			1,008,520
Cost of sales – branch			720,000	
Provision for deciation on machinery		3,000		113,400
Head office cost of sales (including goods sent to branch)	118,000			
Administration costs	30,400		36,000	
Stock – 31 October 2003	57,800		23,040	
Income statement – 1 November 2002		4,000		
Machinery at cost	12,000		252,000	
Remittances		56,000	544,000	
Bank balance	9,200		158,400	
Selling and distribution costs	<u>46,600</u>	<u> </u>	<u>57,600</u>	<u> </u>
	<u>440,000</u>	<u>440,000</u>	<u>1,982,040</u>	<u>1,982,040</u>

Additional information:

- The cost of sales figure includes a depreciation charge of 10% per annum on the cost of machinery.
- A provision of Kshs. 600,000 for unrealized profit in the branch stock is to be made.
- The branch remitted Ushs. 32,000,000 on 30 October 2003 which was not received by the head office until 3 November 2003. The amount realized was Kshs. 3,980,000.
- During September 2003, a customer of the branch paid the head office for goods supplied by the branch. The amount due from him was Ushs. 640,000 which realized Kshs. 72,000. It has been correctly dealt with by the head office but not yet entered in the branch accounts.
- Commission, which is payable to the branch Manager, is to be provided at 5% of the net profits of the branch after charging such commission.
- The relevant exchange rates were as follows:

	Ks hs.	T o	Ush s.
On 1 November 2002	1		10
On 31 October 2003	1		8
Average rate for the year ended 31 October 2003	1		9
On date of purchase of freehold building and machinery	1		7

Required:

- Branch trial balance (after the necessary adjustments) in Kenya shillings. (6 marks)
 - Income statement for the head office, the branch and the combined business for the year ended 31 October 2003. (6 marks)
 - Combined statement of financial position as at 31 October 2003. (8 marks)
- (Ignore the effects of taxation). **(Total: 20 marks)**

QUESTION FOUR

On 1 January 2003, H Ltd., a manufacturer of clay products, made the following investments

- Acquired 60% of the ordinary shares of S Ltd. for Sh.80,000,000.
- Acquired 40% of the preference shares of S Ltd. for Sh.25,000,000
- Acquired 30% of the ordinary shares of A Ltd. for Sh. 55,000,000.

H Ltd. is represented in the board of directors of A Ltd. by two directors.

The draft accounts of H Ltd., S Ltd. and A Ltd. for the year ended 31 December 2003 were as follows:

**Draft profit and loss accounts as at
December 2003**

	H Ltd. Sh. "000"	S Ltd.	A Ltd. Sh. "000"
Turnover	<u>600,000</u>	<u>400,000</u>	<u>350,000</u>
Profit before tax	200,000	180,000	100,000
Taxation	<u>(60,000)</u>	<u>(45,000)</u>	<u>(30,000)</u>
Profit after tax	140,000	135,000	70,000
Less proposed dividends:			-
Preference	-	(30,000)	
Ordinary	<u>(60,000)</u>	<u>(60,000)</u>	<u>(40,000)</u>
Retained profits	80,000	45,000	30,000
Balance brought forward	<u>40,000</u>	<u>60,000</u>	<u>50,000</u>
Balance carried forward	<u>120,000</u>	<u>105,000</u>	<u>80,000</u>

**Draft profit and loss accounts as at
December 2003**

	H Ltd. Sh. "000"	S Ltd.	A Ltd. Sh. "000"
Assets:			
Non-current assets	375,000	195,000	135,000
Current assets:			
Stocks	90,000	85,000	60,000
Debtors	80,000	65,000	40,000
Cash at bank	<u>75,000</u>	<u>50,000</u>	<u>45,000</u>
	<u>245,000</u>	<u>200,000</u>	<u>145,000</u>
Total assets	<u>620,000</u>	<u>395,000</u>	<u>280,000</u>
Equity and liabilities:			
Equity:			
Authorized and fully paid:			
3,000,000 ordinary shares of Sh. 100 par value	300,000		
1,000,000 ordinary shares of Sh. 100 par value		100,000	100,000
500,000 Preference shares of Sh. 100 par value		50,000	
Income statement balance	<u>120,000</u>	<u>105,000</u>	<u>80,000</u>
	<u>420,000</u>	<u>255,000</u>	<u>180,000</u>
Liabilities			
Current liabilities:			
Creditors	80,000	35,000	30,000
Proposed dividends	60,000	60,000	40,000
Taxation	<u>60,000</u>	<u>45,000</u>	<u>30,000</u>
	<u>200,000</u>	<u>140,000</u>	<u>100,000</u>
Total equity and liabilities	<u>620,000</u>	<u>395,000</u>	<u>280,000</u>

Additional information:

1. Non-current assets of H Ltd. include the cost of investments in S Ltd. and A Ltd.
2. H Ltd. has not accounted for dividends receivable from S Ltd. and A Ltd. H Ltd. accounts for dividends due to minority interests as a current liability.
3. The assets in A Ltd. are to be revalued upwards by Sh. 60,000,000 to arrive at their values.
4. Included in the stocks of S Ltd. were goods purchased from H Ltd. for Sh.5,000,000. H Ltd. had marked up the goods by 25% of their cost.
5. On 15 January 2003, S Ltd. made a bonus issue of 2 shares for every 5 held.

Required:

- (a) Consolidated income statement and statement of retained earnings, of H Ltd., its subsidiary and associated company, for the year ended 31 December 2003.
(10 marks)
- (b) Consolidated statement of financial position, of H Ltd., its subsidiary and associated company, as at 31 December 2003.
(15 marks)

(Total: 25 marks)**QUESTION FIVE**

On 1 April 2001 Mega Ltd .acquired 4,500,000 ordinary shares of Ksh.20 par value in Lenga Ltd at a cost of Ksh.152, 000, 000.Further, on 1 July 2001 Mega Ltd acquired 15,000,000 ordinary shares of Ksh 20 par value in Tera Ltd at a cost of Ksh.716, 600,000.Directors were appointed to the boards of both companies by Mega Ltd so as to take an active part in their management. Given below is the information extracted from the books of the companies as at 31 March 2002.

Statement of financial position as
at 31 March 2002

	Mega Sh. '000'	Lenga Sh. '000'	Tera Sh. '000'
Freehold property at cost	720,000	0	200,000
Plant and machinery at cost	1,375,000	450,000	350,000
Stock	380,000	218,000	360,600
Debtors	374,800,	185,000	125,000
Amount due from Mega Ltd	-	-	48,000
Investments	868000	-	-
Bank balances	-	2,000	40,000
	<u>3,717,800</u>	<u>862,000</u>	<u>1,123,600</u>
Share capital	1,000,000	300,000	400,000
Share premium	200,000	24,000	-
Capital reserve	300,000	-	56,000
Retained profit (as at 31 March 2002)	<u>786000</u>	<u>218,000</u>	<u>288,000</u>
	<u>2,286,000</u>	<u>542,000</u>	<u>744,000</u>
Creditors	590,000	110,000	152,000
Amount due to Tera Ltd.	36,000	-	-
Accumulated depreciation –plant and machinery	521,800	120,000	124,600
Taxation	190,000	90,000	103,000
Bank balance	24,000	-	-
	<u>3,717,800</u>	<u>862,000</u>	<u>1,123,600</u>

Additional information is given as follows

8. Profit for the year ended 31 March 2002 after tax and before dividends were as follows;

	Sh
Mega Ltd	252,000,000
Lenga Ltd	102,000,000
Tena Ltd	128,000,000

These profits are included in the retained profits.

9. No interim dividends were paid in the year but final proposed dividends are as follows;

Mega Ltd	20%
Lenga Ltd	10%
Tera Ltd	10%

10. Profits accrued uniformly throughout the year

11. Included in the stock of Mega Ltd. were goods purchased from Tera Ltd. at Sh.40,000,000. Tera had made profits of 25% on cost of the goods.

12. A Remittance of Sh 12,000,000 from Mega Ltd to Tera Ltd at the end of financial year was received in April 2002.

13. On 1 April 2001 plant and machinery of Lenga Ltd was revalued upwards by Sh 240,000,000 and the revaluation was not incorporated in the books. Plant and machinery is depreciated at the rate of 10% per annum based on cost.

14. Goodwill or premium on consolidation is amortized on a straight line basis over five years.

Required

Consolidated statement of financial position of Mega Ltd and its subsidiary as at 31 March 2002 **(20 marks)**

END OF COMPREHENSIVE ASSIGNMENT No.2

NOW SEND TO THE DISTANCE LEARNING CENTRE FOR MARKING

LESSON FIVE

BANKRUPTCY AND LIQUIDATION

OBJECTIVES

At the end of this lesson, you should:

- Know the law relating to the bankruptcy of individuals and partnerships;
- Know the law relating to the receivership of companies;
- Know the law relating to the liquidation of companies;
- Know how to prepare the statements of affairs and the deficiency or surplus account for an individual, a partnership and a company undergoing a creditors' voluntary liquidation or a compulsory liquidation;
- Know how to prepare a statement of assets and liabilities of a company undergoing a members' voluntary liquidation;
- Know how to prepare the accounts of a trustee in bankruptcy, of a liquidator and a receiver of company.

CONTENTS

- Read the study text below.
- Attempt reinforcing questions at the end of the lesson.
- Compare your solutions with those given in Lesson 9.

5.1 DEFINITION OF BANKRUPTCY

FORWARD NOTE:

Bankruptcy is another key area of accounting 3. The issues addressed here deal with the properties of an individual (a sole trader or partner in a partnership) when they become bankrupt. There is a lot of legal issues and most of these are addressed under the Bankruptcy Act. Please go through the notes patiently but emphasise more on the final accounts i.e. the statement of affairs and the deficiency account.

A bankrupt is a person against whom an **adjudication order** has been made by the court primarily on the grounds of his insolvency. Any person (other than a body corporate) can be made bankrupt (including in certain cases, infants and persons of unsound mind) who:

- (a) Has incurred **liquidated** debts of Shs 1,000 or more; and
- (b) Has committed an **act of bankruptcy** within the **three months** preceding presentation of the petition; and
- (c) At the time the petition was presented was domiciled or within a year before, was ordinarily resident in Kenya or carrying on business in Kenya personally or by an agent or as a member of a firm.

5.2 ACTS OF BANKRUPTCY

The following are the acts of bankruptcy on which a petition may be founded:

- (a) Assignment of property to trustee: whereby one gives up all his property to be managed by a trustee
Provided that:
 - i. The assignment is of substantially the whole of the debtor's property, and
 - ii. It is for the benefit of the creditors generally.

Such an assignment will normally be void unless registered as a **deed of arrangement**.

- (b) Fraudulent conveyance: the debtor unfairly transfers his property to one creditor, so that the other creditors have no assets to attach their claims on.
i.e. a transfer of **any** property to **any** person which gives one creditor an unfair advantage, or which tends to defeat or delay creditors.
- (c) **Fraudulent preference**
Where the preference constitutes a conveyance or transfer of property, or a charge thereon,
- (d) **Absenting**
i.e. departing or remaining out of Kenya, or departing from his dwelling-house, or otherwise absenting himself, or 'keeping house', with the intention of defeating or delaying his creditors.
- (e) **Execution against goods**
This is committed when the bailiff has taken possession of goods and either sold them or retained them for 21 days.
- (f) **Petition by debtor**
A bankruptcy petition by the debtor against himself, or a formal declaration of his inability to pay his debts filed with the court, operates as an act of bankruptcy.
- (g) **Non-compliance with bankruptcy notice**
A bankruptcy notice may be issued by a judgement creditor in respect of a final judgment or order for any amount provided that execution has not been stayed or already levied; failure by the debtor to pay the amount of the judgment within seven days of service of the notice constitutes an act of bankruptcy, unless the debtor applies to have it set aside on the grounds of set off, etc.

- (h) **Notice of suspension of payment of debts**
This may be in any form provided it shows a clear intention to suspend payment.

5.3 THE PETITION

(a) **Petition by debtor**

If the debtor presents his own petition, a receiving order is made **at once** without a court hearing and an adjudication order **may** also be **made at once**.

(b) **Petition by creditor**

Any creditor including an assignee of a debt, may petition, provided:

- i. The debt due to him amounts to at least Shs 1,000;
- ii. The debt is **certain** and is for a **liquidated** sum;
- iii. The petition is based on an act of bankruptcy committed within the previous **three months**.
- iv. The debtor is **domiciled** in Kenya, or within the previous year has ordinarily resided or carried on business in Kenya.

A creditor whose debt is less than Shs 1,000 may petition jointly with other, if the aggregate of the debts is Shs 1,000 or more. A secured creditor may only petition in respect of the balance unsecured unless he agrees to surrender his security.

(c) **Presentation and hearing**

The petition is presented to the court and must be served on the debtor at least **eight days** before the hearing. If the debtor wishes to oppose it he must give notice of that fact and the reasons for his opposition at least **three days** before the hearing. The court may dismiss the petition if the creditor fails to prove

- i. The debt
- ii. Service of the petition on the debtor
- iii. The act of bankruptcy relied on or
- iv. If satisfied that the debtor can pay his debts, or for other sufficient cause.

Otherwise it may stay the proceedings on such terms as it thinks fit, or make a **receiving order** against the debtor.

(d) **Protection of debtor's property**

At any time after presentation of the petition, the court may appoint the official receiver (O R) to be **interim** receiver of the property and the O R may himself appoint a **special manager**. The court may also stay any action or other legal process against the debtor.

(e) **The official receiver**

The Official Receiver is an **officer** of the **court** appointed by, and under the supervision of, the Minister. His duties are to investigate the debtor's conduct and report thereon to the court, to act as receiver of the debtors property, summon and preside at the first meeting of creditors, advertise requisite matters in the Kenya **Gazette** and elsewhere, and act as trustee pending appointment of a trustee by the creditors and during any vacancy, and in small bankruptcies. He may appoint a special manager to carry on the debtor's business until a trustee is appointed.

5.4 RECEIVING ORDER

(a) Effect of receiving order

The consequences of the making of the receiving order are:

- i. The debtor retains ownership, but loses possession and control of his property;
- ii. The official receiver becomes receiver of the debtor's property;
- iii. No legal proceedings may be brought in respect of provable debts except by leave of the court;
- iv. Transactions subsequently entered into by the debtor are prima facie invalid;
- v. The receiving order must be advertised in the Kenya Gazette;

(b) Rescission of receiving order:

The order may be rescinded by the court if:

- i. The court has sanctioned a composition or scheme of arrangement;
- ii. The debts have been paid in full; or
- iii. The court otherwise considers that the order ought not to have been made.

(c) Statement of affairs

Within fourteen days of the receiving order '(or before, but not more than three days before, the date of the debtor's own petition) the debtor must submit to the Official Receiver a statement of his affairs verified by affidavit, showing:

1. Particulars of his assets, debts and liabilities;
2. The names, residences and occupations of his creditors;
3. The securities (if any) held by them, and the dates they were given; and
4. Such further or other information as may be prescribed or as the official receiver may require

(d) First Meeting of creditors

The Official Receiver must convene this meeting within 60 days of the receiving order, unless the court extends the time, by giving notice to each creditor mentioned in the statement of affairs and by six days' notice in the Gazette. He must send with the notice a summary of the statement of affairs, his own comments thereon, a form of proof, and details of any scheme proposed by the debtor. The debtor must be given three days' notice of the meeting.

The purpose of the meeting is to decide whether to accept a scheme of arrangement (if any) or to have the debtor adjudged bankrupt, and in the latter case to appoint a trustee and a committee of inspection.

(e) Public examination

This is fixed by the court, on the application of the Official Receiver, as soon as is convenient after the time for submission of the debtor's statement of affairs. Notice must be given to the debtor and the creditors and advertised in the Kenya Gazette and a local paper.

The debtor must attend, and must answer on oath all questions properly put to him about his affairs, even if the answers are incriminating.

If the debtor fails to attend or refuses to answer such questions, the examination may be adjourned sine die (indefinitely), and the debtor adjudged bankrupt forthwith.

5.5 COMPOSITIONS AND SCHEMES OF ARRANGEMENT

The debtor may lodge a written proposal with the Official Receiver for a composition or other arrangement of his affairs **within four days** of submitting his statement of affairs, or such further time as the Official Receiver may allow. The procedure thereon is as follows:

- (a) The Official Receiver must summon a meeting of creditors before the conclusion of the public examination, sending a copy of the proposal to each of them with his report thereon;
- (b) The proposal must be approved by a majority in number and **three fourths** in value of all creditors who have proved;
- (c) If the proposal is accepted by the creditors, it must be approved by the court, three days' notice of hearing being given to each creditor; the hearing cannot take place until after the conclusion of the examination;
- (d) The court cannot approve the proposal until it is heard the Official Receiver's report on the debtor's conduct and any objections of the creditors: the court should approve the proposal if satisfied that the statutory requirement have been complied with, and it is in the interests of creditors generally and not contrary to public policy;
- (e) The court **must refuse** to approve it if:
 - i. The terms are unreasonable or not for the benefit of the creditors generally, or
 - ii. Any of the facts that would disentitle a bankrupt to an immediate unconditional discharge from bankruptcy are proved unless provision is made of at least Shs 25 per Shs 100 on all provable unsecured debts, or
 - iii. Provision is not made for the prior payment of preferential debts;
- (f) If approved by the court, the scheme is binding in respect of all provable debts, except those from which the debtor would not be released on discharge (see paragraph 6.7(a) below);
- (g) The scheme may be annulled if:
 - i. The debtor defaults in payment, or
 - ii. It cannot proceed without injustice or undue delay to the creditors or the debtor, or
 - iii. The court's consent was obtained by fraud.

In practice, such proposals are rare; if a debtor wishes to put forward a scheme, he will normally do so before bankruptcy proceedings are begun.

5.6 ADJUDICATION OF DEBTOR

1. Adjudication order

The court may adjudge the debtor bankrupt on the application of the O.R. or any creditor in the following cases:

- a. If the creditors so resolve at their first meeting, or pass no resolution, or do not meet at all;
 - i. If a composition or scheme is not approved **within 14 days** after the conclusion of the public examination, or such further time as the court may allow;
 - ii. If the debtor applies to be made bankrupt;
 - iii. If there is no quorum at the first meeting of the creditors;
 - iv. If the debtor has absconded or does not intend to propose a composition or scheme;
 - v. If the public examination is adjourned sine die;

- vi. If the debtor fails without reasonable cause to submit his statement of affairs;
- vii. If a composition or scheme is annulled by the court.

2. Consequences of adjudication

The consequences of the making of the adjudication order are:

1. The order must be advertised in the gazette and a local paper;
2. The ownership of the debtor's property vests in the trustee in bankruptcy;
3. The debtor must not obtain credit for shs 100 or more without informing the creditor that he is an undischarged bankrupt; credits under shs 100 can be added together to make this offence r v. Hartley (1972);
4. The debtor must not engage in any trade or business under a different name without disclosing the name under which he was adjudicated;
5. The debtor cannot act as a company director or take part in the management of a company except by leave of the court;
6. The debtor cannot act as a receiver or manager of the property of a company unless appointed by the court;
7. The debtor cannot be appointed or act as a justice of peace or be elected to or hold the office of mayor or member of local authority council, school committee or road board: this disqualification operates for five years after discharge unless he obtains a certificate of misfortune or the bankruptcy is annulled.

3. Annulment of order

The order may be annulled if

- a. In the opinion of the court the debtor ought not to have been adjudicated bankrupt;
- b. All the debts have been paid in full; or
- c. A composition or scheme is accepted by the creditors and approved by the court.

As to (b) voluntary release of a debt is not equivalent to payment; a **disputed** debt is considered as paid in full if the debtor enters into a bond to pay it if the dispute is settled in favour of the creditor and a debt due to an **untraceable** or unidentifiable creditor by payment of the debt into court. The court may refuse an annulment, although the debts have been paid in full, or the O.R. reports that the bankrupt has committed bankruptcy offenses.

An annulment must be advertised in the Kenya Gazette, and releases the debtor from the disabilities of bankruptcy, but does not invalidate payments or other acts properly made by the Official Receiver or the trustee. The property of the debtor vests in such person as the court directs, or otherwise reverts to the debtor.

5.7 DISCHARGE OF BANKRUPT

1. Application of discharge

Application may be made at any time after adjudication, but cannot be heard until the conclusion of the public examination. Notice of the hearing must be given in the Kenya Gazette, and **14 days'** notice given to every creditor. The Official Receiver must report to the court on the bankrupt's conduct, and the bankrupt is entitled to a copy of this report at least **seven days** before the hearing.

The court may -

1. Grant an absolute and immediate discharge;
2. Refuse the application; or
3. Grant a suspended or conditional discharge;

4. In particular, the court may only grant a discharge suspended for a definite period or until at least Shs 50 per Shs 100 has been paid to all creditors, or a conditional discharge subject to judgement being entered against the bankrupt for all or part of the unpaid balance of provable debts, if either -
- (a) The bankrupt has been convicted of a bankruptcy offence, or
 - (b) Any of the "facts" set out on s.29 (3) have been proved against him; such "facts" include - assets less than Shs 50 per Shs 100 of unsecured liabilities; failing to keep proper books of account; knowingly trading when insolvent; gambling; extravagant living or neglect of business; frivolous litigation; previous bankruptcy, composition or scheme; fraud or fraudulent breach of trust.

2. Effect of discharge

An order of discharge releases the bankrupt from all disabilities imposed by the bankruptcy (except those which apply for a fixed period after discharge - see paragraph. 6.6 (b) (g), and from all **provable** debts except:

- i. Debts due to the government for breach of a revenue statute, or on recognizance, unless the Treasury gives written consent to his release;
- ii. Debts incurred by fraud or fraudulent breach of trust;
- iii. Liability under a judgment for seduction, or under an affiliation order, or as a correspondent in a divorce action, unless the court otherwise orders.

The order does not release him from liability to prosecution for bankruptcy offenses.

3. Revocation of discharge

The court may revoke or vary the order of discharge in the event of the debtor's failure to assist as required in supplying information or in the realisation of the estate.

5.8 THE TRUSTEE IN BANKRUPTCY

a. Appointment of trustee

The trustee is appointed:

- i. By the creditors by ordinary resolution, or
- ii. By the committee of inspection, if so resolved by the creditors, or
- iii. By the court if a trustee is not otherwise appointed within **four weeks** of the adjudication or within **seven days** of rejection of a composition or scheme.

A vacancy is filled in the same way, the court having power to appoint if the vacancy is not filled within **three weeks**. A trustee appointed by the court may be replaced by a new trustee appointed by the creditors or committee of inspection.

b. Court objections

The court may object to a trustee appointed by the creditors or committee of inspection on any of the following grounds:

- i. Appointment not made in good faith by a majority in value of creditors voting;
- ii. Person appointed not fit to act as trustee;
- iii. Trustee's relationship with bankrupt or a creditor makes it difficult for him to act impartially;
- iv. Misconduct or failure to render accounts or deal properly with unclaimed moneys, in a previous trusteeship.

Certificate of appointment

If the court has no objection to the trustee, and the trustee gives security of the nature and amount required, the court will certify that his appointment has been duly made, and the appointment takes effect from that date. The trustee must advertise his appointment in the Kenya Gazette and in a local paper.

5.9 COMMITTEE OF INSPECTION

i. Appointment

A committee of inspection may be appointed by the creditors at their first or any subsequent meeting to supervise the trustee.

ii. Membership

The committee consists of between **three** and **five** members, who must be creditors whose proofs have been admitted, or the holders of general proxies of powers of attorney from them; a person may be appointed before, but cannot act until, these conditions are satisfied. Membership may be terminated by:

1. Written resignation to the trustee;
2. Bankruptcy of member or arrangement with his creditor;
3. Failure to attend five consecutive meetings; or
4. Removal by creditors.
5. Vacancies are filled by the creditors.

iii. Meetings

Meetings must be held at least once a month and may be called by the trustee or any member; a majority of members constitutes a quorum.

iv. Fiduciary position of members

A member is not entitled to payment for his services or to enter into any transaction in relation to the bankrupt's estate, except with the sanction of the court.

5.10 RIGHTS AND DUTIES OF TRUSTEE

8. Powers of trustee

1. Of his own initiative, he may:

1. Sell and transfer any part of the bankrupt's property;
2. Gives receipts for money received;
3. Take all necessary steps to recover debts due to the bankrupt;
4. Exercise any powers vested in him under the bankruptcy act (cap.53)
5. Bar an entail; and
6. Do all necessary or expedient acts in his official name.

2. With permission of the committee of inspection or the court, he may:

1. Carry on the business of the bankrupt;
2. Bring and defend legal proceedings relating to the bankrupt's property;
3. Employ a solicitor or other agent;
4. Sell property in consideration of a future payment;

5. Mortgage or pledge any part of the property;
6. Refer disputes to arbitration and compromise claims;
7. Distribute property in specie among creditors;
8. Appoint the bankrupt to manage his property or carry on his trade for the benefit of the creditors; and
9. Pay such allowances as he thinks fit to the bankrupt for the support of himself and of his family.

9. **(b) Right of indemnity**

If the Official Receiver or trustee has seized or disposed of any property in the possession of the debtor, without notice or claim relating thereto, he is not personally liable to any person having a claim against that property, unless the court is of opinion that he has been negligent.

10. **(c) Remuneration of trustee**

This is fixed by ordinary resolution of the creditors, or by the committee of inspection. It takes the form of a commission payable partly on the amount realised by him less sums paid to **secured** creditors, and partly on the amount distributed as dividend. The court may fix the amount at the request of one-fourth in number or value of the creditors or of the bankrupt, if satisfied that the agreed amount is too large. If the trustee receives any other payment he loses all right to remuneration.

11. **(d) Accounts of trustees**

The trustee must keep proper books of account, which may be inspected by the creditors at any time. The cash book must be audited by the committee of inspection at least once every three months, and the trading account examined and certified by them at least once a month. The accounts must be submitted for audit by the Official Receiver every six months and when the estate has been fully realised and distributed, one copy of the audited accounts is retained by the Official Receiver and another filed with the court. The trustee must also submit to the Official Receiver a progress report at least once a year.

12. **(e) Trustee's bank account**

The trustee must pay all money received into the Bankruptcy Estates Account at the prescribed bank if he retains sums exceeding Shs 1,000 for more than ten days, he is liable to pay 20% per annum interest on the amount, loses his rights to remuneration, may be removed from office, and is liable to pay any expenses incurred through his being advantageous to the creditors of the committee of inspection, or the trustee satisfies the court that there are good reasons for doing so. The trustee cannot draw cheques on the Bankruptcy Estates Account; only the Official Receiver can do so.

5.11 RESOLUTIONS OF CREDITORS

Normally, decisions at meetings of creditors are taken by ordinary resolution, viz., a resolution passed by a simple majority in value of creditors present, personally or by proxy, and voting on the resolution.

A **special** resolution, viz., a resolution passed by a simple majority in number and **three-fourths in value** of the creditors present and voting, is required:

- (a) To appoint a trustee other than the Official Receiver in a small bankruptcy;
- (b) To make an allowance to the bankrupt in a form other than money;

(c) To require the Official Receiver to remove a special manager.

5.12 TERMINATION OF OFFICE OF TRUSTEE

The trustee may vacate office in the following ways:

1. (a) Resignation

He may resign at a meeting of creditors and with their consent.

2. (b) Removal

He may be removed either by the creditors by ordinary resolution, or by the court, if:

- i. He is guilty of misconduct or failure to perform his statutory duties;
- ii. The trusteeship is being needlessly protracted;
- iii. He is incapable of performing his duties;
- iv. He is unable to act impartially; or
- v. He has been removed from office in another bankruptcy for misconduct.

3. (c) Receiving order

He automatically vacates office if a **receiving order** is made against him..

4. (d) Release

He may be released by the court when the administration of the estate is complete, or he has resigned or been removed.

Upon release he is discharged from liability in respect of any act or default as trustee, unless his release was obtained by fraud or concealment of material facts.

The release must be gazetted and the trustee must deliver to the O.R. all books and papers in his possession.

5.13 DIVISIBLE PROPERTY

The property of the bankrupt divisible among creditors includes:

- (a) Property belonging to the bankrupt at the commencement of the bankruptcy;
- (b) Property acquired by him before his discharge ("after - acquired property"); and
- (c) In certain cases, property owned by, or in the hands of, third parties.

The 'property' of a bankrupt includes property held under a joint tenancy (*Re Rushton, 1972*)

5.14 DEBTOR'S PROPERTY AT COMMENCEMENT OF BANKRUPTCY

i. Doctrine of "relation back"

The trustee's title to the debtor's property is deemed to relate back to the *commencement of the bankruptcy*, i.e., the time the act of bankruptcy was committed on which the receiving order was made or, if the bankrupt committed more than one act of bankruptcy, the time of the first such act committed *within the three months* preceding presentation of the petition.

All property belonging to the bankrupt at the commencement of the bankruptcy is divisible among creditors, with the following exceptions:

ii. Protected transactions

These fall into three categories:

a. Under Section 50:

- i. Payments by the bankrupt to creditors;
- ii. Payments or deliveries to the bankrupt;
- iii. Conveyances or assignments by the bankrupt for value; provided that:
- iv. Other contracts, dealings or transactions by or with the bankrupt for value;

Provided that:

- (1) The transaction took place before the date of receiving order, and
- (2) The other party did not notice of an available act of bankruptcy.

b. Under Section 51:

Any payment or delivery to the bankrupt or his assignee,

- i. Before the date of the receiving order,
- ii. Without notice of *presentation* of the petition, and
- iii. Either pursuant to the ordinary course of business or otherwise *bona—fide*.

This includes payments made to a third party "on the request, order or direction of the bankrupt" (*Re Dalton*)

c. Payment or transfer of money or property of the bankrupt by a person in possession of it to some other person, after the date, but before the gazetting, of the receiving order, provided that the transferor had no notice of the receiving order.

Such a transaction is not completely protected - but no claim can be made against the transferor unless it is "not reasonably practicable" for the trustee to recover it from the transferee.

iii. Completed executions

A judgement creditor cannot retain the "benefit" of an execution or attachment, unless he has completed it-

- i. Before the date of the receiving order, and
- ii. Without notice of the presentation of a petition or the commission of an available act of bankruptcy,

but he can retain any money received by him before that date (*Re Andren*).

If the judgement **exceeds** Shs 400 the bailiff must retain the proceeds of sale for 14 days, and hand over the proceeds to O.R. or trustee, if notice of a petition is served on him during that time; and the same applies if, before sale, notice is served on him that a receiving order has been made.

The court has a discretion to set aside these rights in favour of the creditor if it thinks fit.

iv. Trust Property

Property held by the bankrupt on trust for any other person does not pass to his trustee.

v. Excepted articles

The trustee cannot claim the tools of the bankrupt's trade or necessary wearing apparel and bedding of the bankrupt and his family to a total value not exceeding Shs 500.

vi. Determinable interests

The trustee cannot claim property in which the bankrupt's interest is determinable upon bankruptcy, except property settled by the bankrupt on himself on these terms.

vii. Personal rights of action

Rights of action relating to the bankrupt's property pass to the trustee, but those affecting his person, e.g. for assault or libel, do not.

viii. Contracts of personal service

Contracts involving the personal skill of the bankrupt do not pass to the trustee: other contracts do unless disclaimed.

5.15 AFTER-ACQUIRED PROPERTY

All property acquired by the bankrupt between the commencement of bankruptcy and his discharge passes to the trustee, except as stated above and below.

(a) Rule in Cohen v Mitchel

Property acquired by the bankrupt after adjudication may be validly transferred by him to a third party taking in good faith and for value, before the trustee has intervened to claim the property; the bankrupt must then account to the trustee of the consideration received.

Payments to or by a banker are deemed to be for value for this purpose, but a banker who discovers that a customer is an undischarged bankrupt must not make payments out of his account without informing the trustee of its existence and seeking his instructions.

(b) Salary and other income

The bankrupt's income from whatever source, passes to the trustee, unless otherwise provided by statute as, e.g. in the case of certain pensions. In respect of personal earnings, however the bankrupt is entitled to keep sufficient for the maintenance of himself and his family. The trustee can apply to the court for any periodical payments due to the bankrupt to be paid directly to himself.

(c) Subsequent bankruptcies

If an undischarged bankrupt is adjudicated for a second or further time, property acquired by him after the first adjudication vests in the trustee in the subsequent bankruptcy, unless it had been distributed at the time the subsequent petition was presented.

A trustee having notice of a subsequent petition must retain after-acquired property in his possession for transfer of the trustee in the subsequent bankruptcy, and may prove for its value in that bankruptcy.

5.16 PROPERTY IN BANKRUPT'S REPUTED OWNERSHIP

The trustee may claim property owned by third parties which is in the bankrupt's possession at the commencement of the bankruptcy if:

1. The property consists of goods or business debts;
2. In the sole possession, order or disposition of the bankrupt at the commencement of the bankruptcy;
3. For use in his trade or business;
4. With the consent of the true owner;

5. In such circumstances that the debtor was the 'reputed owner' of the goods.

The trustee's claim may be defeated by evidence of a trade custom of possession of such goods without ownership; in view of the prevalence of hire purchase and similar agreements, this clause now seems to have little practical importance.

5.17 PROPERTY TRANSFERRED BEFORE BANKRUPTCY

(a) Voluntary settlements

The trustee can claim all property settled by the bankrupt on other persons within two years preceding the bankruptcy unless made:

- a. Before and in consideration of marriage; or
- b. In favour of a person taking in good faith and for value; or
- c. For his wife or children in respect of property accruing to him in right of his wife.

The trustee may further claim property settled within ten years of bankruptcy, unless it is proved:

- a. That at the time of making the settlement, the bankrupt could pay all his debts without the aid of the settled property, and
- b. All interest of the bankrupt in the property passed at the time the settlement was made.

(b) Agreements to settle property

The trustee is not bound by such an agreement if it remains executory. If property has already been settled, the trustee can recover it unless it is proved:

- i. That the settlement was made more than two years before the bankruptcy, or
- ii. That, at the date of the settlement the bankrupt was able to pay all his debts without the aid of the settled property, or
- iii. The agreement related to property expected to accrue to the bankrupt on the death of a named person and was made within three months of its coming into his possession.

(c) Fraudulent preferences

The trustee can set aside any transaction effected within the six months preceding the presentation of the petition in circumstances such as to make it a fraudulent preference, i.e., a voluntary transaction by an insolvent person in favour of a creditor, or his trustee, with the dominant intention of giving the creditor or a surety, a preference over the other creditors.

(d) Fraudulent conveyances

The trustee may set aside a transfer of property made by the bankrupt before the commencement of bankruptcy with the intention of defrauding creditors, unless the transferee took the property for good or valuable consideration, in good faith and without notice of that intent.

The trustee cannot recover property in any of the above cases which has been further transferred to a person taking in good faith and for value.

Assignments of book debts

The trustee can set aside an assignment of existing or future book debts, whether absolute or by way of charge, unless the assignment was registered as an absolute bill of sale, except in the case of debts-

- i. Due at the time of the assignment from specified debtors; or
- ii. Growing due under specified contracts; or
- iii. Included in a bona fide transfer of a business for value; or
- iv. Included in an assignment of assets for the benefit of creditors generally.

5.18 DISCLAIMER OF ONEROUS PROPERTY

1. Effect of disclaimer

The trustee may disclaim onerous property consisting of:

- i. Land burdened with onerous covenants;
- ii. Stocks and shares;
- iii. Unprofitable contracts, or
- iv. Other property which is not readily saleable by reason of the liabilities attaching thereto;

and thereupon all the rights, interests and liabilities of the bankrupt and of the trustee in relation to the property are determined as from the date of disclaimer.

2. Time for disclaimer

The trustee may disclaim in writing at any time within twelve months of his appointment, or of becoming aware of the property, or such extended period as the court may allow.

This right is lost if a person interested in the property applies in writing for him to decide whether he will disclaim or not; in this case the trustee must give notice of disclaimer within 28 days of receiving the application, unless the court extends the time:

The court's consent is not required to the disclaimer except in the case of certain leases.

3. Disclaimer of leases

In principle where the bankrupt is a lessee the lease cannot be disclaimed without leave of the court; but such leave is not required in the following cases.

1. If the property is not sublet or mortgaged and
 - i. Its real value is less than Shs 400 p.a.; or
 - ii. The estate is being administered summarily, or
 - iii. The trustee serves notice of his intention to disclaim on the lessor and the lessor does not within seven days require the matter to be brought to court;
2. If the property is sublet or mortgaged and the trustee serves all parties with notice of his intent to disclaim and no party within 14 days requires the matter to be brought to court.

4. Rights arising on disclaimer

Any person interested in property disclaimed may apply to the court for an order vesting the property in himself; but the court will not make a vesting order in respect of a lease unless the lease is taken subject to the same liabilities and obligations as bound the bankrupt.

Any person injured by the disclaimer may prove in the bankruptcy to the extent of his loss.

5.19 PROVABLE DEBTS

All debts and liabilities present or future, certain or contingent, are provable in bankruptcy, except:

- (a) Claims for unliquidated damages in tort;
- (b) Debts incurred after the creditor had notice of an available act of bankruptcy;
- (c) Debts incapable of being fairly estimated;
- (d) Debts incurred after the date of the receiving order;
- (e) Debts void or unenforceable under the ordinary law of contract;
- (f) Maintenance payable by a husband to his wife.

Non-provable debts, if otherwise enforceable, are unaffected by the bankruptcy and can be enforced after discharge.

In the case of contingent debts e.g. possible liability as an indorser of a bill of exchange, the trustee must estimate the value of the contingent liability. If the creditor is aggrieved he may appeal to the court which may itself value the liability. If, in the opinion of the court, the liability cannot be fairly estimated the debt will not be provable.

(g) **Guarantees**

The creditor or a surety (but not both) may prove in the bankruptcy of the principal debtor; a surety may prove in the bankruptcy of a co-surety; and a creditor may prove in the bankruptcy of a surety.

(h) **Bills of exchange**

The holder may prove in the bankruptcy of all prior parties, unless the bill was made for his accommodation.

(i) **Annuities**

An annuitant may prove for the estimated value of the annuity; if he dies before the proof is accepted, the amount becomes certain and the proof must be amended; if he dies after declaration of a dividend, the payment on the estimate cannot be disturbed, even though it exceeds the amount actually due.

(j) **Periodical payments**

Rent and other payments falling due at stated periods may be apportioned and proof from the person entitled to payment may be lodged for the proportionate part accruing due at the date of the receiving order.

(k) **Interest**

Interest may be claimed-up to the date of the receiving order - if it is payable:

- i. By agreement;
- ii. By statute;
- iii. If the debt was created in writing and due at a certain time at 6% p.a. from due date; or
- iv. Otherwise, after written demand for payment giving notice that interest is claimed, at 6% p.a. from date of demand.

Interest over 6% p.a. is a deferred debt, although except in the case of a moneylender, the trustee can admit proof for the full amount.

Statutory interest is payable in all debts at 6% p.a. from the date of the receiving order, if there is a surplus after payment of all debts in full.

Sums paid to the creditor before the receiving order must be apportioned between principal and interest.

5.20 MUTUAL DEALINGS

A right of set-off is allowed where there have been -

- (a) Mutual credits, debts or other dealings resulting in pecuniary liabilities,
- (b) Between the debtor and a creditor in the same right,
- (c) Prior to the date of the receiving order,
- (d) Without notice of an available act of bankruptcy.

An account is taken as at the date of the order, and the balance paid or claimed by the creditor. Persons with mutual dealings cannot contract out of the right of set-off given by s.36 *ibid* though it may be possible for them to agree that their dealings shall not be regarded as mutual. **National Westminster Bank Ltd. v Halesowen Presswork and Assemblies Ltd. (1972).**

5.21 SECURED CREDITORS

A secured creditor may:

- (a) Rely on his security and not prove at all.
- (b) Surrender his security and prove for the full amount of the debt.
- (c) Realise his security (if he has a power of sale) and prove for the balance; or
- (d) Estimate the value of his security and prove for the balance.

He must disclose the security in his proof or surrender it to the trustee unless the court grants relief. If the creditor estimates his security

- i. If proof used for voting purposes trustee may within 28 days require him to give up security on payment of its estimated value plus 20% or amount at which revalued by creditor;
- ii. If valued for dividend purposes trustee may redeem it at any time by paying its assessed value or if dissatisfied with valuation require security to be sold;
- iii. He may by writing, require trustee to redeem security or have it realised, and if trustee does not do so within six months property vests absolutely in creditor;
- iv. He may amend valuation and proof at any time unless he has called upon trustee to redeem it;
- v. He may realise security and amend his proof accordingly.

5.22 LANDLORD'S RIGHT OF DISTRESS

The Landlord's right to distrain for arrears of rent is not lost on the tenant's bankruptcy, but

- (a) Distress can only be levied after commencement of bankruptcy for up to six month's rent due prior to adjudication and is not available for rent payable after date of distress;
- (b) If distress is levied within three months preceding date of receiving order, proceeds are subject to a first charge in favour of preferential creditors; if the landlord suffers loss as a result he acquires the same rights of priority as the preferential creditors who are paid;
- (c) He can distrain for rent due after adjudication if trustee remains in possession and does not disclaim lease; if tenant's goods have been seized in execution of a judgment, landlord can claim up to one year's arrears out of proceeds, or six months' arrears if claim made after commencement of bankruptcy.

Unless the landlord has distrained he has no priority over the creditors.

5.23 PROOF OF DEBTS

The following rules apply as to the proving of debts:

- (a) A creditor has no right to vote or receive dividends until his debt is proved to the satisfaction of the trustee;
- (b) Proofs should be made by affidavit as soon as possible after the receiving order - but may be accepted at any time before the final dividend;
- (c) Proofs may be made provisionally accepted for voting at the first meeting of creditors;
- (d) The trustee (but not the O.R.) must deal with a proof within 28 days of receipt; if the proof is rejected the creditor may appeal to the court within 21 days;
- (e) The trustee must satisfy himself that there is a real debt; he is not bound by any judgement or estoppel against the debtor;
- (f) The trustee may apply to the court to expunge or reduce a debt wrongfully admitted;
- (g) The trustee must each month file with the court all proofs admitted or rejected in the previous month and on declaring a dividend he must send to the court a list of proofs so filed;
- (h) Proof on a contingent debt may be admitted for dividend purposes but not for voting while the contingency remains;
- (i) **Double proof is not allowed** in the same bankruptcy for the same debt but proof may be lodged against two separate estates for the same debt.

5.24 ORDER OF PAYMENTS

The bankrupts estate must be distributed in the following order.

1. Cost and charges

Costs and charges properly incurred in administering the estate must be paid in priority to all debts and in the proper sequence.

2. Pre preferential debts

These are:

- (a) Proper funeral and testamentary expenses of a deceased insolvent;
- (b) Premiums paid by apprentices or articed clerks;
- (c) Property of a friendly society of which the bankrupt is an officer; and
- (d) Expenses properly incurred by a trustee of a deed of arrangement.

If funds are insufficient to pay these in full, they abate rateably.

3. Preferential debts

These include:

- (a) Local rates and amounts deducted as P.A.Y.E by a bankrupt employer from employees' pay accruing due during the twelve months preceding the receiving order;
- (b) Up to one year's arrears of any other assessed taxes;
- (c) Wages and salary due to employees for work done during the four months preceding the receiving order up to Shs 4,000 per employee;
- (d) Rents due to the Government not more than five years in arrear;
- (e) Employer's national social security fund contributions due during the previous twelve months.
- (f) Amounts due for compensation under the Workmen's Compensation Act. If funds are insufficient to pay these in full, they abate rateably.

4. Unsecured debts

These rank equally after payment of preferential debts in full.

5. **Deferred debts**

These include:

- (a) Accrued interest in excess of 6% per annum, due to an unsecured creditor; (paid in priority to other deferred creditors).
- (b) Salary or wages due to or money or other property lent by a relative by consanguinity or affinity i.e. a grandparent, parent, uncle or aunt, brother or sister or cousin, child (including adopted child) or nephew or niece, grandchild or any person married to any one of these; or a husband or wife.
- (c) Loans to a person for business purposes at a rate of interest varying with profits; b) and c) rank equally — proof cannot be admitted for any purpose until all other debts are paid in full.
- (d) Statutory interest at 6% per annum; and
- (e) Claims arising under a settlement set aside by the trustee.

6. **Surplus**

Any surplus remaining after payment of all debts and other liabilities in full must be returned to the bankrupt.

5.25 DIVIDENDS

Dividends must be declared and paid in accordance with the following rules:

- (a) The **first** dividend must be declared and paid **within four months** of the first meeting of the creditors, unless postponed with the consent of the committee of inspection;
- (b) **Subsequent** dividends must be declared and paid at intervals of not more than six months;
- (c) The trustee must give not more than **two month's** notice of intention to declare a dividend to every creditor mentioned in the statement of affairs who has not proved his debt, requiring proof to be lodged not later than a date at least 14 days from the date of the notice; he must admit or reject all proofs within 14 days of the date specified; appeal against rejection must be commenced within seven days; the trustee must have the notice gazetted;
- (d) After declaring a dividend, details thereof must be sent to every creditor who has proved and must be gazetted;
- (e) The trustee must make provision for creditors who have not had time to submit proofs, or to establish disputed claims, and for the expenses of administration;
- (f) A creditor who has not proved before declaration of a dividend may be paid if the trustee has any money still in his hands, and may participate in future dividends;
- (g) If a dividend is paid on a future debt, a rebate of interest at 6% per annum from the date of the dividend to the date for payment of the debt must be deducted;
- (h) A final dividend may be declared when all the bankrupt's property has been realised, or so much of it as can be realised without needlessly protracting the trusteeship; notice must be given to persons who have notified, but have not established, their claims, requiring them to do so within the time specified in the notice;
- (i) Unclaimed dividends remaining in the hands of the trustee for six months must be paid into the Bankruptcy Estates Account; the receipt of the Official Receiver discharges the trustee in respect thereof, any claimant must apply to the Official Receiver for payment.

5.26 SMALL BANKRUPTCIES

The court may order the estate of a debtor to be administered summarily, if the debtor's assets **are not likely to exceed** Shs 12,000 in value. This is known as a "small bankruptcy" or "summary case"

A small bankruptcy differs from an ordinary bankruptcy in the following respects:

1. The Official Receiver acts as trustees;
2. There is no committee of inspection — the court gives all necessary consents;
3. The proceedings need not be advertised in a local paper;
4. The court may adjudge the debtor bankrupt forthwith if no composition or scheme is proposed;
5. The first meeting of creditors may be held at the same time as the public examination or at any other given time fixed by the Official Receiver;
6. Notice of subsequent meetings need not be sent to creditors whose claims do not exceed Shs 40;
7. A single dividend is paid, if possible, within six months of the first meeting of creditors;
8. Simpler accounts are required;
9. Costs, other than a solicitors', need not be taxed, unless required by the O.R.;
10. The court's consent is not required to disclaim leases not sublet or mortgaged.

5.27 DEEDS OF ARRANGEMENT (D of A)

1. Nature of a D of A

To avoid the expense and delay involved in a bankruptcy, a debtor in trouble may make a private arrangement with the creditors to accept payment of a smaller sum of money in full discharge of their debts **before** a bankruptcy petition has been presented. In contrast to compositions and schemes of arrangement (see paragraph 6.5 above) the arrangement will be outside the bankruptcy law. Such arrangements will bind only those creditors who assent to the arrangement and the debtor will not be released from the claims of the others,

Whereas under a composition or scheme or arrangement the debtor is released from all claims except those from which he would not be released by his discharge from bankruptcy.

These arrangements will usually come within the ambit of the **Deeds of Arrangement Act**. The D.A.A. defines a D of A as any instrument, whether under seal or not, made for the benefit of creditors generally, or made by an insolvent debtor for the benefit of three or more creditors. It may be:—

- (a) An assignment of property
- (b) A deed of composition
- (c) A deed of inspectorship for carrying on or winding up a business
- (d) A letter of license authorising a debtor or any other person to carry on or dispose of a business with a view to the payment of debts
- (e) Any agreement for the carrying on or winding up a debtor's business with a view to the payment of his debt (**DAA s.3**).

2. Registration of a D of A and assent of creditors

A D of A will be void unless it is registered with the Registrar within 7 clear days after first execution and is properly stamped (**DAA s.4**).

Within 21 days after registration a deed for the benefit of creditors generally must be assented to by a majority in number and value of the creditors concerned. This assent can be given by the creditor signing the D of A or by signing a separate deed of assent. Further, the trustee appointed by the deed must file a statement that the necessary majority of creditors has assented to the deed. This declaration must be filed within 28 days after the D of A itself was registered (**DAA s.5**).

3. Effect of bankruptcy

A D of A made for the benefit of creditors generally will be an act of bankruptcy and therefore a bankruptcy petition may be presented against the debtor within 3 months of its execution by a creditor who has not assented to the D of A (but if such creditor has been served by the trustee under the D of A with a notice of the execution of the D of A the time is reduced to 1 month). The trustee should therefore not act under the D of A for 3 months after its execution unless all creditors have assented to it because if the debtor becomes bankrupt the D of A will be void and the doctrine of relation back will apply, the trustee having to account to the trustee in bankruptcy for all dealings with the debtor's property; however all expenses properly incurred by the trustee of the D of A in the performance of his duties must be paid to him by the trustee in bankruptcy as a first charge on the estate (**DAA s.23**).

Normally if a D of A is void the trustee under the D of A must account for dealings with the debtor's property even if a bankruptcy petition is presented **after** the lapse of 3 months from the D of A. But, in the latter event, if the D of A is void by reason only that

- (a) The requisite assents from the creditors have not been obtained **or**
- (b) In the case of a D of A for the benefit of three or more creditors, by reason only that the debtor was insolvent at the time of the execution of the D of A and that the D of A was not registered in accordance with the **DAA** and the trustee did not know and had no reason to suspect that it was void, the trustee is not liable to account for dealings with the debtor's property which would have been proper had the deed been valid (**DAA s.21**).

4. Appointment of trustee

The trustee is nominated by the parties to the deed and, his appointment is made and his remuneration fixed by the deed. In the event of his death, resignation or incapacity, the parties may appoint a new trustee who must immediately notify the registrar of his appointment. If the parties to the deed cannot agree upon a new trustee, or wish to remove an existing trustee, the court may appoint a new trustee under **The Trustee Act, s.42**.

5. Trustee's security

Within 7 days from the filing of the declaration of assent by the requisite creditors, the trustee of a D of A for the benefit of creditors generally must give security to the local bankruptcy registrar in a sum equal to the estimated assets available for distribution among the unsecured creditors. This security can be dispensed with, however, by a majority in number and value of the creditors (**DAA s.13**).

6. Trustee's accounts and audit

A Trustee under a D of A must account annually to the Official Receiver and every 6 months to all assenting creditors. A majority in number and in value of creditors can demand an audit during the administration or within 12 months from the rendering of the final accounts to the O.R.

7. Trustee's duties in administering the D of A

- (a) To carry out the trusts of the D of A and to distribute the property assigned to him in accordance with the provisions of the D of A.
- (b) To pay all creditors equally unless the D of A gives priority to those debts which would be preferential in bankruptcy (as it usually will)?

Note that since the B.A does not apply to the D of A, rules such as those relating to disclaimer of onerous property, reputed ownership and voidable settlements are inapplicable.

8. Discharge of trustee

The trustee is automatically discharged as soon as he has carried out his duties under the D of A — he does not have to obtain a formal release.

5.28 BANKRUPTCY ACCOUNTS FOR INDIVIDUALS AND PARTNERSHIPS

These include a statement of affairs and deficiency account.

A statement of affairs takes the following form:

INDIVIDUAL

STATEMENT OF AFFAIRS AS AT (DATE), DATE OF RECEIVING ORDER

Gross Liabilities Sh '000'	Liabilities as stated & estimated by debtor	Expected to rank Sh '000'	Assets as stated & estimated by debtor	Sh '000'	Estimated to produce Sh '000'
x	Unsecured creditors	x	Cash at bank		x
x	Creditors fully secured	x	Cash in hand		x
	Less value of security	(x)	Stock-in-trade		x
	Surplus to contra	x	Machinery		x
x	Creditors partly secured	x	Trade fixtures		x
	Less value of security	(x)	Furniture		x
		x	Life policies		x
x	Liabilities on bills discounted	x	Stocks, shares and other investments		
x	Contingent and other liabilities	x	Bank debts: Good		x
x	Preferential creditors deducted per contra	x	: Doubtful	x	
			: Bad	x	
				x	
			Estimated to produce		x
			Bills of exchange	x	
			Estimated to produce		x
			Surplus from secured Creditors per contra		x
			Deduct preferential Creditors per contra		(x)
			Deficiency as per Deficiency a/c		x
<u>xx</u>		<u>xx</u>			<u>xx</u>

DEFICIENCY (SURPLUS) A/C

	Sh '000'		Sh '000'
Excess of assets over liabilities (One year before receiving order)	x	Losses from Trading	x
Excess of private assets over Liabilities (one year before receiving Order)	x	Estimated loss on realization of Assets	x
Net profits from the business for the Period under review	x	Drawings	x
Other receipts-gifts legacies etc	x		
Deficiency as per statement of affairs	x		
	<u>xx</u>		<u>xx</u>

Example

Njuguna Mwandawiro, carrying on a business as a trader in Likoni, Mombasa, finds himself insolvent, and on 15 August 1997 files his petition in bankruptcy. The following balances are extracted from the books of his business on that date:

	Sh		Sh
N. Mwandawiro Capital	1,200,000	Shop – land and buildings	4,000,000
Mortgage on shop (land and buildings)	3,000,000	Furniture and fittings	1,000,000
Loan – I.C.D.C. Ltd.	1,200,000	Stock of goods	575,100
Loan – Barclays Bank Ltd.	600,000	Debtors	641,300
Loan – Co-operative Bank Ltd.	200,000	N. Mwandawiro drawings	1,314,000
Loan – Paul Nkobei	100,000	Cash on hand	2,000
Loan – Mutiso Kuria	20,000		
Trade creditors	1,140,000		
N.H.I.F., N.S.S.F. and P.A.Y.E.	36,000		
Salaries and wages payable	18,000		
Bank overdraft	<u>18,000</u>		
	<u>7,532,400</u>		<u>7,532,400</u>

The following information is provided:

1. The trade creditors includes Sh.30,000 owing to Mombasa Municipal Council in respect of rates in for the current period and a small loan from Mwandawiro's friend Waititu for Sh. 10,000.
2. The amount owing for salaries and wages and statutory payroll deductions are for 1997.
3. There is 210,000 interest unpaid on the mortgage as at 15 August 1997, which has not been recorded in the books.
4. The loan from I.C.D.C. Ltd. is secured by a second mortgage on the shop (land and buildings). The unrecorded interest owing as at 15 August 1997 was Sh.96,000.

5. The loan from the Co-operative Bank Ltd. was obtained when Mwandawiro pledged his wholly owned piece of land as security. The value of the piece of land is sh.300,000. There is no interest outstanding on his loan.
6. The interest on loan from Paul Nkobei was to vary with profits, but since the business has been operating at a loss, there is no interest due.
7. There is no interest outstanding on the loan from Barclays Bank Ltd.
8. Mutiso Kuria is Mwandawiro's brother-in-law.
9. The value of the assets is estimated to be:

	Sh.	
Shop – land and buildings	4,200,000	
Furniture and fittings	800,000	
Stock of goods	200,000	

10. Of the debtors, Sh.400,000 are thought to be good and Sh.200,000 doubtful, of which Sh.150,000 should be collectable.
11. Mwandawiro's uncle died recently and he will be receiving Sh.50,000 as an inheritance.
12. Mwandawiro has no personal creditors outside the business, but he has other personal assets, beside the piece of land, amounting to Sh.60,000, exclusive of household and personal effects.

Required:

- (a) A statement of affairs for Njuguna Mwandawiro as at 15 August 1997 in good form
(15 marks)
 - (b) A deficiency account as at that date. (4 marks)
 - (c) Income statement for the period ended 15 August 1997. (3 marks)
- (Total: 22 marks)**

Solution

NJUGUNA MWANDAWIRO

STATEMENT OF AFFAIRS AS AT 15 AUGUST 1997

GROSS LIABILITY	LIABILITIES	EXPECTED TO RANK SHS.	ASSETS	ESTIMATED TO PRODUCE Sh.
1,848,000	Unsecured creditors (W1)	1,848,000	Cash on hand	2,000
3,410,000	Fully secured creditors (W2)	3,410,000	Stock	200,000
	Less: value of security	4,500,000	Furniture	800,000
	Surplus below	(990,000)	Personal assets	60,000
	Surplus per contra	(100,000)	Debtors – Good	400,000
1,296,000	Partly secured creditors (W3)	1,296,000	Debtors – Doubtful	200,000
	Deduct surplus from above)		Debtors – Bad	41,300
	Deficiency ranking unsecured	(990,000)	Estimated to produce	150,000
84,000	Preferential creditors deducted per contra (W4)	306,000	Inheritance receivable	50,000
		84,000	Surplus from fully secured creditors per contra	100,000
				1,762,000
			Preferential as per contra	(84,000)
			Deficiency as per deficiency account	1,678,000
6,658,400		2,154,400		476,400
				2,154,400

WORKINGS

1. Unsecured creditors

	Sh.
Barclays bank loan	600,000
Loan from Paul Nkotei	100,000
Loan from Mutiso Kuria	20,000
Trade creditors (1,140,000 – 30,000)	1,110,000
Bank overdraft	18,400
	<u>1,848,400</u>

Assumption: Kuria is married to Mwendawiro's sister making him a relative by consanguinity.

2. Fully secured creditors

	Liabilities	Security	Surplus
Shop mortgage	3,210,000	4,200,000	990,000
Cooperative Bank loan	<u>200,000</u>	<u>300,000</u>	<u>100,000</u>
	<u>3,410,000</u>	<u>4,500,000</u>	<u>1,090,000</u>

3. Creditors partly secured:

	Liabilities	Value of Security	Deficit
ICDC Loan (1,200 + 96)	1,296,000	990,000	306,000

4. Preferential creditors

	Sh.
Mombasa municipal council (Note 1)	30,000
Salaries and wages payable	18,000
NHIF, NSSF & PAYE	<u>36,000</u>
	<u>84,000</u>

DEFICIENCY ACCOUNT

Sh.		Sh.	
Excess of business assets over liabilities	1,200,000	Estimated Loss on realization of assets:	
Excess of private assets over liabilities	<u>360,000</u>	Furniture	
	1,560,000	Stock	200,000
Estimated surplus:	200,000	Debtors	375,100
On realization on land & buildings	50,000	(641,300–400,000–150,000)	<u>91,300</u>
Gift from uncle by will		Unrecorded expenses	
Deficiency as per statement of account	<u>476,400</u>	Mortgage interest	210,000
	<u>2,286,400</u>	ICDC loan interest	96,000
		Drawings	1,314,000
			<u>2,286,400</u>

The format for the statement of affairs and surplus or deficiency account of a partnership will be as follows:

STATEMENT OF AFFAIRS

	Joint Estate	A	B		Joint Estate	A	B
Unsecured creditors	x	x	x	Assets not specifically			
Creditors fully secured	x	x	x	Pledged	x	x	x
Less value of security	(x)	(x)	(x)	Surplus from creditors			
Surplus below/contra	x	x	x	Fully secured		x	x
Creditors partly secured	x	x		Preferential creditors			
Less value of security/surplus b/d	(x)	(x)		deducted per contra	(x)	(x)	(x)
Preferential creditors	x	x		Surplus from B's			
Deducted per contra	x	x	x	Personal estate	x		
Surplus as per surplus a/c			x	Deficiency as per deficiency a/c	x	x	
	xx	xx	xx		xx	xx	xx

SURPLUS/DEFICIENCY A/C

	Joint Estate	A	B		Joint Estate	A	B
Excess of assets over Liabilities	x	x	x	Est. loss on realization Of assets	x	x	x
Est. surplus on realization Of assets	x	x	x	Loss on guarantee		x	
Surplus from B's Estate	x			Loss of partnership Capital		x	x
Deficiency as per Statement of affairs	x	x		Surplus as per Statement of affairs			x
	xx	xx	xx		xx	xx	xx

Example

Akili and Bidii trade in a partnership under the name of Jaribio Enterprises. One of the creditors of the partnership presented a petition in bankruptcy against the partnership and the High Court made out a Receiving Order on 31 October 1996.

The assets and liabilities of the joint and separate estates on that date were as follows:

Values	Book Value			Estimated Realisable		
	Jaribio	Akili	Bidii	Jaribio	Akili	
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh.
Bidii						
Land and buildings	11,750	3,000	4,500	13,500	4,800	
5,000						
Plant and equipment	13,640			8,500		
Furniture & household						
Goods		600	850		200	
420						
Stock	16,300			9,700		
Debtors	10,790			4,750		
Partnership capital		4,000	6,000			
Investments		2,000	1,000		3,350	
800						
Cash	200	100	300			
Motor car	500	900	1,500		300	
	<u>52,680</u>	<u>10,600</u>	<u>14,150</u>			
Capital accounts: A	4,000					
B	6,000					
Creditors	24,320	260	180			
Bank overdraft	8,360					
Loans secured on land						
And buildings	10,000	2,500	3,000			
Loans secured on cars		600	1,000			
Personal surpluses		<u>7,240</u>	<u>9,970</u>			
	<u>52,680</u>	<u>10,600</u>	<u>14,150</u>			

Additional information:

1. Of Jaribio's creditors, Sh.700, 000 are preferential.
2. Jaribio's bank overdraft was secured by a second mortgage on the partnership, land and buildings and by the personal guarantee of Akili together with the deposit of his investments.
3. Akili and Bidii share profits or losses equally.

Required:

Statements of Affairs and Deficiency or Surplus Accounts for the firm and for the separate personal estates of the partners, using the format laid down in the Bankruptcy Act and showing the legal position in relation to the double proof.

Solution Akili and Bidii

Akili and Bidii

Statement of affairs as at 31 October 1996

	Joint Estate Sh '000'	Akili Sh.'000'	Bidii Sh.'000'		Joint Estate Sh. '000'	Akili Sh.'000'	Bidii Sh.'000'
Unsecured creditors	23,620	260	180	Cash	200	100	300
Creditors fully secured	10,000	2,500	3,000	Stock	9,700	-	-
Less value of security	13,500	4,800	5,000	Investments	-	-	800
Surplus below/to contra	3,500	2,300	2,000	Plant & equip	8,500	-	-
Creditors partly secured	8,360	8,960	1,000	Furniture and Household	-	200	420
Less value of security	3,500	3,650	500	Debtors	4,750	-	-
Deficiency ranking as Unsecured	4,860	5,310	500	Surplus from fully secured creditors	-	2,300	2,000
Per contra	-	-	-	Per contra	23,150	2,600	3,520
Pref. Creditors deducted	-	-	-	Surplus from B's Estate	2,840	-	-
Per contra	700	-	-	25,990	2,600	3,520	
				Less pref. creditors	-	-	-
				Per contra	(700)	(-)	(-)
				25,290	2,600	3,520	
Surplus as per surplus a/c	-	2,840	-	Deficiency per deficiency a/c	3,190	2,970	-
	28,480	5,570	3,520	28,480	5,570	3,520	

Deficiency a/c

	Joint Estate Sh. '000'	Akili Sh. '000'	Bidii Sh. '000'		Joint Estate Sh. '000'	Akili Sh. '000'	Bidii Sh. '000'
Excess of assets over liabilities	10,000	7,240	9,970	Loss on o/d guarantee		8,360	
Estimated surplus on Realisation of assets:				Loss of P.ship capital		4,000	6,000
Land and buildings	1,750	1,800	500	Est. loss on realisation of assets:			
Investments	-	1,350	-	• Motor car		600	1,000
Surplus from B's estate	2,840			• Investment		-	200
Deficiency as per SOA	3,190	2,970	-	• Debtors		-	-
	<u>17,780</u>	<u>13,360</u>	<u>10,470</u>	• Stock		-	-
				• Plant		-	-
				• Furniture		-	-
				Surplus as per SOA		-	-
					-	400	430
					-	-	2,840
					<u>17,780</u>	<u>13,360</u>	<u>10,470</u>

Workings for unsecured creditors:

	Sh. '000'	Sh. '000'	Sh. '000'	
	Joint Estate	Akili	Bidii	
Trade creditors	24,320	260	180	
Less pref. Creditors	<u>(700)</u>	<u>(-)</u>	<u>(-)</u>	
Unsecured creditors	<u>23,620</u>	<u>260</u>	<u>180</u>	

Workings for fully secured creditors

	Sh. '000'	Sh. '000'	Sh. '000'	
	Liability	Security	Surplus	
Joint Estate: Loans (L & B)	<u>10,000</u>	<u>13,500</u>	<u>3,500</u>	
Akili: Loans (L & B)	<u>2,500</u>	<u>4,800</u>	<u>2,300</u>	
Bidii: Loans (L & B)	<u>3,000</u>	<u>5,000</u>	<u>2,000</u>	

Workings for partly secured creditors

	Sh.'000'	Sh.'000'	Sh.'000'
Joint Estate: Bank o/d	<u>8,360</u>	<u>3,500</u>	<u>4,860</u>
Akili: Bank o/d	8,360	3,350	5,010
: Car Loan	<u>600</u>	<u>300</u>	<u>300</u>
	<u>8,960</u>	<u>3,650</u>	<u>5,310</u>
Bidii: Car Loan	<u>1,000</u>	<u>500</u>	<u>500</u>

6.28 RECEIVERSHIPS

APPOINTMENT OF RECEIVER

If a company defaults in payment of principal or interest, or otherwise defaults in observing the conditions contained in debentures issued, a receivership may result. . A receiver can only be appointed where the debentures are secured by a fixed or floating charge, or both.

Where power is given in the terms of issue, the debenture holders or their trustees, if there is a trust deed, may appoint a receiver without having to apply to the court; and where the terms of issue provide for such an appointment, they usually provide also for the events upon the happening of which he shall be appointed, e.g. non—payment of principal, interest in arrears.

If no power to appoint a receiver is given by the terms of issue, the trustee for the debenture holders, or a debenture holder acting on behalf of himself and others, may ask the court to appoint a receiver. Before such an appointment will be made it will be necessary for the applicant to show that:-

- (a) Default is made in payment of principal or interest
- (b) The company is being wound up, or
- (c) The security is in jeopardy.

An appointment will be made under (c) where there is a serious risk that the security may be seized to satisfy claims which do not rank in priority to those of the debenture holders, e.g., where unsecured creditors obtain a judgement and levy execution; but mere insufficiency of the security is not itself "jeopardy" re **(New York Taxicab Co)**.

A body corporate may not be appointed S.345 (Companies Act 1962), nor an undischarged bankrupt, except under an appointment by the court S.346. The official receiver may be appointed if the company is being wound up by the court S.347.

The duties of a receiver are to get in and realise the assets subject to the charge - he has no power to carry on the business of the company; if such a power is required, as where there is a floating charge on the company's business or undertaking and it is desired to sell the business as a going concern, the receiver (or some other person) may be appointed manager to carry on the business for this purpose: if appointed by the court this will be for a limited period, usually three months.

Effects of the appointment of the receiver:

- (a) Floating charges: these crystallise on the appointment of a receiver and become fixed on the assets then in the hands of the company, which cannot be dealt with without the receiver's consent.
- (b) Directors: their powers to deal with the assets charged are suspended, but their appointments are not terminated.
- (c) Employees: if the receiver is appointed by the court, they are automatically dismissed, but may be re-employed by him (Reid v Explosives Co.): if appointed out of court as agent of the company, their position is not affected (re Mack Trucks Ltd 1967).

If appointed by the court, the receiver must give security as directed by the court.

The following notification must be given:

- (a) The debenture holders must give notice of the appointment to the registrar within seven days for entry in the register of charges s.103,
- (b) If appointed receiver or manager of substantially the whole of the company's assets under a floating charge, the receiver must give notice of his appointment forthwith to the company s.351 (1)(a),

- (c) Every invoice, order for goods or business letter on which the company's name appears must state that a receiver or manager has been appointed s.349.

Where (b) above applies, the company must, within 14 days of receiving the notice (or such longer period as the court or the receiver may allow), submit a statement of affairs to the receiver s. 351 (1)(b), verified by affidavit or statutory declaration by a director and the secretary, and showing.

- i. Particulars of the company's assets, debts and liabilities
- ii. Names, residences and occupations of creditors
- iii. Securities, if any, held by them, and the dates on which they were given, and

- (d) Such further or other information as may be prescribed **s.352(1)**.

The receiver may, if necessary, require the statement to be submitted by:

- (a) Past or present officers of the company
- (b) Persons who have taken part in the formation of the company at any time within the previous year
- (c) Persons employed by the company within the previous year, and capable, in the opinion of the receiver, of giving the information required
- (d) Persons who are or have been within the previous year officers or employees of a company which is or has been within that year an officer of the company **s.352(2)**.

Within two months of receipt of the statement of affairs the receiver must send:

- (a) A copy of the statement of affairs
- (b) His comments thereon (if any)
- (c) A summary of the statement of affairs, and
- (d) A summary of his comments, to:
 - i. The registrar
 - ii. The court (if appointed by the court) - (a) and (b) only
 - iii. The company - (b) only, or a notice that has no comments to make, and
 - iv. To the debenture holders and their trustees (if any) - (c) only **s.351(1) (c)**.

Apart from the duties imposed by law, the receiver should, upon appointment, master the terms of his appointment and ensure the validity of the charge, and, if he is appointed manager:- open an account as receiver and have existing balances and all moneys received paid into that account: give instructions that no goods are to be ordered or payments made without his authority, and that all letters etc., are to comply with s.349; make arrangements for continuing or terminating contracts of employment; take an inventory of all the assets; check insurances; and prepare lists of the company's debtors and particulars of the debts.

If the receiver is appointed by the court, he is an officer of the court, and no action can be brought against him, or taken or continued by him without leave of the court; he is not the agent of either the company or the debenture holders.

- (a) Liability on contracts: he is personally liable on contracts made by him, with a right of indemnity against the company's assets; he is not bound by existing contracts except by novation, but he should carry out such contracts if failure to do so would damage the company's goodwill.

- (b) Borrowing powers: he may obtain leave of the court to borrow money on security ranking in priority to the debentures, and may borrow without security in the ordinary course of business without leave.
- (c) Remuneration: this is fixed by the court.

If the receiver is appointed out of court, prima facie, he is the agent of the debenture holders, but he is usually expressly appointed as agent of the company; he may apply to the court for directions s.348 (1).

- (a) Liability on contracts: he is personally liable to the same extent as if appointed by the court and with the same right of indemnity s.348(2); if appointed as agent of the company the debenture holders are not liable for his acts, but he may require an indemnity from them before accepting the appointment; he ceases to be the company's agent and his authority as manager (if any) to carry on the company's business is revoked in the event of winding up.
- (b) Borrowing powers: the same as if appointed by the court.
- (c) Remuneration: this is fixed by agreement with the debenture holders, but the court may fix it retrospectively on the application of the liquidator s.350.

If appointed in circumstances to which s.351 applies (see above) he must within two months of the end of each year after his appointment and of ceasing to act send an abstract of his receipts and payments during that period and the aggregate amounts of receipts and payments since his appointment to:

- (a) The registrar
- (b) The company, and
- (c) The debenture holders and their trustees if any s.351 (2).

Otherwise, e.g. where the charge is a fixed charge only on certain assets, if appointed out of court, he must send similar accounts every six months and on ceasing to act to the registrar s.353; and, if appointed by the court he must file accounts with the court as often as the court may require.

If the receiver is appointed in respect of debentures secured by a floating charge, he must pay in full those debts which would be preferential in liquidation under s.311 before paying the debenture holders s.95. The order of payments out of the proceeds that the receiver has realised is:

- (a) Cost of realisation
- (b) Receiver's costs and remuneration
- (c) Trustee's remuneration (if any)
- (d) Plaintiff's cost of action (if receiver appointed by court)
- (e) Preferential creditors (if applicable)
- (f) Debenture holders.

If appointed by the court, the receiver is discharged by order of the court and his security released; if appointed out of court, he is discharged by agreement with the debenture holders, and, in this case, notice of his ceasing to act must be given to the registrar for entry in the register of charges s.103(2).

6.29 LIQUIDATION OF COMPANIES

(a) Methods of Winding Up

A company may be wound up:

- i. By the court
- ii. Voluntarily, either as a members' or a creditors' winding up; or
- iii. Subject to the supervision of court s.212

(b) **Grounds for compulsory winding up**

A company may be wound up by the court under s.219 if:

- a. The company so resolves by special resolution,
- b. Default is made in delivering the statutory report or holding the statutory meeting; a petition can be presented by members only at least 14 days after the last available date for the meeting s.221: the court may order the report to be delivered or the meeting held instead of making a winding-up order s.222,
- c. The company has not commenced business within a year of incorporation or has suspended business for a whole year (and has no intention of carrying on or resuming business: (Middlesbrough Assembly Rooms Co.)
- d. The number of members fall below seven, or two if a private company
- e. Company is unable to pay its debts: this is deemed to be so if -
 1. A creditor for more than Shs 1,000 has served a written demand for payment on the company, and payment has not been made within three weeks; or
 2. Execution or other process on a judgement remains wholly or partly unsatisfied; or
 3. It is otherwise proved to the satisfaction of the court that the company cannot pay its debts, taking into account its contingent and prospective liabilities s.220.
 4. The court is of opinion that it is just and equitable for the company to be wound up, e.g., substratum gone, (re German Date Coffee Co), deadlock in management (re Yenidje Tobacco Co Ltd), company a "bubble" or formed for a fraudulent or illegal purpose mismanagement or misapplication of funds by directors of a private company (Loch v John Blackwood Ltd). The petitioner may rely on any circumstance of justice or equity which affects him, in a capacity, in his relations with the company or with the other shareholders (Ebrahimi v Westbourne Galleries 1972).

(c) **Persons Who May Petition**

A petition may be presented by any of the following:

2. A Creditor

A creditor may petition if his debt exceeds Shs 1,000 and is undisputed. The order is made as of right, unless the majority of creditors oppose it, in which case it is for the majority to justify their opposition unless the company is already in voluntary liquidation (re **J. D. Swain Ltd**).

"Creditor" includes a contingent or prospective creditor (if he gives security for costs: s.221), a debenture holder, and an assignee of a debt.

3. A Contributory

A contributory is a person liable to contribute to the assets of the company in the event of winding up s.213: this includes all present members (even though their shares are fully paid) and past members who ceased to be members during the year preceding the winding up and the personal

representative of a deceased member - but not the trustee in a member's bankruptcy or the holders of share warrants.

A contributory can only petition if:

- a. The number of members has fallen below the statutory minimum; or
- b. His shares:
 - i. Were originally allotted to him, or
 - ii. Have been held by him in his own name for at least six of the preceding 18 months, or
 - iii. Have devolved on him through the death of a former holder s.221.
- c. There will be assets for distribution among the members: if the company is insolvent a contributory has no tangible interest in the winding up (Re Rica Gold Washing Co.)

4. The Official Receiver

The Official Receiver may petition if the company is already being wound up voluntarily or under supervision and the liquidation cannot proceed with due regard to the interests of the creditors or contributories, e.g., because of the liquidator's misconduct s.221 (2).

5. The Company

The company may petition in consequence of a special resolution passed for this purpose.

6. The Attorney General

The A.G. may petition if it appears from an inspector's report that it is expedient in the public interest that the company concerned should be wound up (P.D.A. 1963, s.16; C.A. 1967, s.81).

(d) The Petition

The petition must be in the prescribed form and verified by affidavit, and must be advertised in the **Gazette** and a local paper seven clear business days before the hearing. Any creditor or contributory is entitled to be heard on the petition if he has previously given notice to the petitioner that he intends to appear and that he supports or opposes the petition. The court may dismiss the petition, or adjourn it, or make a winding-up order or make any other that it thinks fit s.222.

(e) Interim Liquidator

An application to the court for such an appointment (usually of the O.R.) may be made at any time between presentation and hearing, especially if the assets are in jeopardy s.235: he takes control of all the company's property and no legal proceedings can thereafter be begun or continued against the company without leave of the court s.228. The court may also stay any action against the company during this period on the application of the company or any creditor or contributory s.223.

(f) Effect of Winding-up Order

The consequences of a winding-up order are:

- a. Any disposition of the company's property and any transfer of shares is void, unless the court otherwise orders s.224: this provision "relates back" to the commencement of the winding up, i.e., the date of presentation of the petition, or, if the company has previously passed a resolution to wind up voluntarily, the date of that resolution s.226,
- b. Any attachment, execution or distress against the property of the company after the commencement of the winding up is void s.225,
- c. No legal proceedings may be begun or continued against the company without leave of the court s.228,

- d. The O.R. becomes provisional liquidator (contrast provisional liquidator in note e above) until a liquidator is appointed s.236, and may apply to the court for the appointment of a special manager to carry on business of the company pending the appointment of a liquidator s.258,
- e. Every invoice, order or business letter on which the company's name appears must state that the company is being wound up s.329,
- f. The company's employees are automatically dismissed, and the director's powers are terminated.

(g) **Procedure after Winding-up Order**

1. A copy of the order must be filed by the company with the registrar s.227.
2. The company must deliver a statement of affairs to the Official Receiver within 14 days of the order, or of the appointment of a provisional liquidator s.232 (the details are the same as in the case of a receivership: see paragraph 6.28 above.
3. The Official Receiver must submit a report to the court as soon as practicable after receiving the statement of affairs showing:
 - a. The amount of issued, subscribers and paid-up capital and the estimated amount of debts and liabilities,
 - b. The causes of the company's failure, if any, and
 - c. Whether further inquiry is desirable s.233.

If he thinks fraud has been committed he may submit a further report and the court may then order the public examination of any promoter or officer named therein s.265.

4. The first meetings of creditors and contributories are summoned by O.R.. These must be held within one month of the order, or within six weeks if a special manager has been appointed, by notice in the Gazette and a local paper, and seven days' notice to each creditor and contributory, accompanied by a summary of the statement of affairs and his comments thereon: the meetings determine whether to appoint a liquidator and a committee of inspection and, if so, to nominate them s.236.

(h) **Appointment of Liquidator**

The liquidator is appointed by the court after the above meetings have been held: if the meetings do not agree, the court must settle the issue: if no appointment is made the O.R. continues as liquidator ss.236.

A liquidator other than the O.R. must notify his appointment to the registrar and give security to the satisfaction of the O.R. s.237, and must advertise his appointment.

The liquidator may be removed by the court, vacancies in the office are filled by the court, and his remuneration is fixed by the court. s.238.

Note. A body corporate cannot be appointed liquidator in any kind of winding up s.326.

(i) **Committee of Inspection**

Appointed by the court if so decided at the above meetings s.248, s.249. There is no prescribed number of members, but it should be representative of both creditors and contributories. The function of the committee is to assist and supervise the acts of the liquidator.

(j) **Dissolution**

If the winding up continues for more than a year, the liquidator must file progress reports with the registrar at such intervals as the court may prescribe s.333. When the winding up is complete the liquidator may either:

- (a) Apply to the court for an order dissolving the company, and file a copy of the order with the registrar within 14 days s.269: the dissolution operates from the date of the order, but the court may declare it void at any time within two years s.352; or
- (b) Apply to the registrar to strike the company's name off the register as being defunct 5338: the registrar will then strike off the company's name two years after the release of the liquidator by three months' notice to the O.R. and in the **Gazette**.

(k) **Defunct Companies**

A company may be dissolved under s.338 without winding up if the registrar has reasonable cause to believe it is defunct: The procedure is:

- a. Registrar writes to company asking if it is still in operation
- b. If no reply within one month, the registrar sends registered letter within next 14 days warning that company will be struck off if no reply within one month
- c. If no reply, notice to company and in Gazette that company will be struck off after three months unless cause shown
- d. Company struck off the notice to effect in Gazette: dissolution from date of notice
- e. To protect members and creditors, the liability of every office and member continues as if the company had not been dissolved, and the court can wind up the company notwithstanding that it has been struck off: moreover on the application of any member, creditor or of the company, the court may within ten years order restoration to the register whereupon the company is deemed to have continued in existence as if its name had never been struck off.

(l) **Resolution For Voluntary Winding Up**

A company may be put into voluntary liquidation:

- i. By ordinary resolution: where any period fixed for the duration of the company has expired or any event upon which the company is to be dissolved has happened;
- ii. By special resolution: for any reason whatsoever. s.271;

The resolution must be advertised in the Kenya **Gazette** and in a newspaper within 14 days s.272, and the winding up is deemed to commence from the passing of the resolution s.273.

(m) **Effect of Resolution**

The consequences of the resolution to wind up are:

- i. The company must cease to carry on its business except so far as is necessary for the beneficial winding up thereof s.274
- ii. The corporate state and powers of the company continue until it is dissolved s.274,
- iii. A transfer of shares without the liquidators's sanction and any alteration in the status of the members is void s.275,
- iv. There is no automatic stay of proceedings against the company, but the court has a discretion to do so on the application of the liquidator or a creditor or contributory s.301
- v. Invoices, letters, etc, must state that the company is being wound up s.329
- vi. The directors' powers cease, unless their continuance is sanctioned by the liquidator or the company in the case of a members' voluntary winding-up, or the creditors or the committee of inspection in the case of a creditors' voluntary winding-up ss.278, 290,

- vii. The company's employees are automatically dismissed if the company is insolvent (Fowler v Commercial Timber Co.); otherwise probably not.

(n) **Members' Voluntary Winding Up**

The company may be wound up by the members themselves without reference to the creditors, if the company is solvent.

1. **Declaration of solvency**

To do this all the directors, or a majority if more than two, must make a statutory declaration of solvency to be filed with the registrar within the 30 days preceding the resolution to wind up. This must state that the directors have made a full inquiry into the company's affairs and have formed the opinion that the company will be able to pay its debts in full within a period not exceeding twelve months of the commencement of winding up, and it must embody a statement of the company's assets and liabilities practicable date s.276.

2. **Appointment of liquidator**

The liquidator is appointed and his remuneration fixed by the members in general meeting s.278, and any vacancy is filled in the same way s.279. He must advertise his appointment in the **Gazette** and notify it to the registrar within 14 days s.299. The court has power, if necessary, to appoint and remove a liquidator s.298. The liquidator has similar powers to those in compulsory winding up, and also the power to make calls and convene meetings s.297.

3. **Further meetings**

If the winding up continues for more than a year, the liquidator must convene a meeting of the company at the end of that and each further year, and lay before it an account of his conduct of the winding up during the preceding year s.282.

4. **Dissolution**

When the winding up is complete, the liquidator must call a final meeting of the company by one month's notice in the **Gazette** and in a local newspaper, and lay before it an account of the winding up and the disposition of the company's property. He must send a copy of this account and a return of the holding of the meeting within a week thereof to the registrar, and after a further three months the company is automatically dissolved s.283: but the court may declare the dissolution void within the next two years s.338.

(o) **Creditors' voluntary winding up**

If no declaration of solvency is filed the winding up must take place under the control of the creditors.

1. **Meeting of creditors**

The company must summon a meeting of creditors for the same day or the day following that on which the meeting of members is held to pass the resolution to wind up, by notice to the creditors and by advertisement in the **Gazette** and a local newspaper. The directors must lay before the creditors' meeting a statement of the company's affairs and a list of creditors, and appoint one of their number as chairman s.286.

2. **Appointment of liquidator**

Both the members and creditors (by a majority in number and in value or the creditors voting in person or by proxy) nominate a liquidator. The creditors' choice prevails if they differ, but in this case the court may be asked, within seven days of the nomination, to make the appointment s.287. If the members have nominated a liquidator and the creditors have not met, the liquidator has power to act until his appointment is terminated by the creditors. His remuneration is fixed by the committee of inspection or the creditors s.289 and vacancies are filled by the creditors s.291. Sections 297-299 (see paragraph m 1, 2 above) apply.

3. **Committee of inspection**
Both the members and creditors may nominate up to five persons, but the creditors may object to the members' nominees who will not then be able to act unless the court otherwise directs s.288.
 4. **Further meetings and dissolution**
The position is the same as in a members' winding up, except that meetings of creditors must also be held whenever meetings of members are required ss.293, 294.
- (p) **Conversion of members' to creditors' winding up**
If the liquidator in a members' winding up forms the opinion that the company will not be able to pay its debts in full within the period stated in the declaration of solvency, he must forthwith summon a meeting of creditors and lay before it a statement of the company's assets and liabilities, and thereafter the winding up proceeds as if it were a creditors' winding up ss.281, 284. A creditor or contributory may petition for a compulsory winding up, notwithstanding that the company is being wound up voluntarily s.303. An application by a contributory will only be upheld if the court is satisfied that the rights of contributories will be prejudiced by the voluntary winding up. In the absence of special circumstances a creditor's application will fail if the other creditors wish the voluntary winding up to continue.
- (q) **Winding up under supervision**
Virtually obsolete, in consequence of s.303 and the power to invoke the court's assistance under s.301. If a supervision order is made, the effect is the same as on the making of a winding-up order (except that the O.R. does not become liquidator): the procedure is the same as in voluntary winding up, but the court may impose restrictions on the liquidator and will require him to submit regular reports on the conduct of the winding up: the court may appoint an additional liquidator ss.304-308.
- (r) **Realisation of assets**
1. **Divisible property**
The ownership of the company's property does not vest in the liquidator (unless the court makes a vesting order: s.240); but he must take it under his control and apply it in satisfaction of the debts, and distribute any surplus among the members according to their respective rights and interests ss.239,296. The property available for this purpose is:
 1. All the property of the company at the commencement of winding up.
 2. Property seized in execution of a judgement which was not completed by that date
 3. Property used to give a fraudulent preference to creditors s313. Any transaction made by a company which cannot meet its debts as they fall due with a view to preferring one creditor to another, within 6 months of the commencement of the winding up, is void.
 2. **Recovery of property**
The following steps may be taken to recover the company's property:
 - a. A private examination may be held by the court of any person thought capable of giving information as to the company's property or affairs s.263
 - b. Public examination of a promoter or officer may be held on a further report by the Official Receiver s.265: (see paragraph g,3 above)
(The above steps are only available in a compulsory liquidation).

- c. If it appears that the company has carried on business with intent to defraud creditors or for any fraudulent purpose, the court may order any person who were knowingly parties to the fraud to be personally liable without any limitation of liability for such debts of the company as the court may direct s.323.
- d. Misfeasance proceedings may be brought against any promoter, officer, manager or liquidator for the recovery of money or property or the contribution of a just sum to the company's assets s.324.

3. Disclaimer

The liquidator may disclaim onerous property consisting of:

1. Land burdened with onerous covenants;
2. Stocks and shares;
3. Unprofitable contracts, or
4. Other property which is not saleable by reason of the liabilities attaching thereto;

and thereupon all the rights, interests and liabilities of the company in relation to the property are determined as from the date of disclaimer.

The liquidator may disclaim **in writing** at any time **within twelve months** after commencement of the winding up, or such extended period as the court may allow.

This right is lost if a person interested in the property applies in writing for him to decide whether he will disclaim or not; in this case the liquidator must give notice of disclaimer within 28 days of receiving the application, unless the court extends the time.

The court's consent is not required to the disclaimer except in the case of certain leases.

Any person interested in property disclaimed may apply to the court for an order vesting the property in himself.

Any person injured by the disclaimer may prove in the liquidation to the extent of his loss.

(s) Contributories

In compulsory winding up, the court must settle a list of contributories, distinguishing between present (A List) and past (B list) members s.252: written notice must be given by the liquidator to every person on the list by leave of the court or committee of inspection ss.255, 268. The court may dispense with settlement of the list of contributories if it appears that it will not be necessary to make calls on or adjust the rights of contributories s.252.

In voluntary winding up the liquidator settles the list and normally follows the above procedure.

(t) Distribution of Assets

1. Proof of debts

If the company is insolvent, the rules in bankruptcy as to provable debts, secured creditors, interests, mutual dealings, annuities and contingent claims apply ss. 309, 310: if the company is solvent all claims enforceable at the commencement of winding up are provable. In compulsory liquidation the rules in bankruptcy as to the method of proving debts apply: formal proof is not necessary in voluntary liquidation.

2. Preferential debts

These are almost the same as in bankruptcy, with the addition that any person who has advanced money for the payment of wages has the same priority as the person receiving payment out of the

advance would otherwise have had s.311. The "relevant date" for calculating these debts is the date of the resolution to wind up, or the date of the winding-up order or of the appointment of a provisional liquidator. There are no pre-preferential debts in liquidation, and the only deferred debt is interest in excess of 6 per cent per annum.

The preferential debts in bankruptcy include the following:

- a. Local rates and amounts deducted as P.A.Y.E. from employees' pay accruing due during the twelve month preceding the commencement of the winding up;
- b. Up to one year's arrears of any other assessed taxes;
- c. Wages and salary due to employees (but not directors) for work done during the four months preceding the winding-up up to Shs 4,000 per employee;
- d. All government rents not more than one year in arrears;
- e. Employer's National Social Security Fund due during the previous twelve months;
- f. Any amounts, which have accrued before the winding up due to employees in respect of any compensation under the Workmen's Compensation Act.

3. Dividends

In compulsory liquidation, the rules are the same as in bankruptcy, except that they are payable "as and when" there are assets available. In voluntary liquidation dividends are paid without formality at the discretion of the liquidator.

4. Unclaimed assets

Money representing unclaimed dividends or undistributed assets must, after six months, be paid into the Companies Liquidation Account: any person who later claims the assets may apply to the O.R. for payment, which will be made on certification by the liquidator: any property of a dissolved company (unless held on trust for some other person) vests in the government as bona vacantia s.340 subject to the Crown's right of disclaimer s.341. The books and papers of the company may be disposed of as directed by the court, the members or the creditors, but the court may order their preservation for up to five years from dissolution s.332.

6.30 Bankruptcy Accounts: The Statement of Affairs and Deficiency Account For An Individual

i. The Statement of Affairs

The statement of affairs sets out:

- (a) The various assets of the debtor, at the values they are expected to realise;
- (b) The creditors, classified according to their "priority".

The balancing figure on the statement of affairs is the estimated deficiency as at the date at which it was prepared.

For a sole trader, one statement of affairs will be prepared to include all assets and liabilities, whether private or business.

For a partnership, a statement of affairs is prepared in respect of the partnership assets and liabilities - called the joint estate. A separate statement is also prepared for each partner, showing his personal assets and liabilities. Any surplus on a separate estate becomes an asset of the joint estate and vice versa.

The pro-forma statement of affairs sets out the order in which assets are shown.

The order in which liabilities are discharged is:

1. Secured creditors, out of the proceeds of their security;
2. Costs and expenses of the bankruptcy; (these are not included in the Statement of Affairs because they have not been incurred at the date at which it is prepared);
3. Pre-preferential creditors (see paragraph 6.24 above);
4. Preferential creditors (see paragraph 6.24 above);
5. Unsecured creditors;
6. Deferred creditors (see paragraph 6.24 above);
7. Any balance to the debtor.

ii. The Deficiency Account

Purpose of deficiency account

The purpose of the deficiency account is to explain the deficit shown on the statement of affairs.

The deficiency account opens with the surplus of assets over liabilities of the bankrupt, one year before receiving order. This figure consists of the capital account of his business plus his net private assets at that date.

Items contributing to deficit:

The following items will be shown on the right-hand side of the deficiency account as being items contributing to the deficit:

1. Losses during the period as per the profit and loss account;
2. Bad debts;
3. Drawings and household expenses;
4. Estimated losses on the realisation of assets:
 - a. Stock
 - b. Machinery
 - c. Property
 - d. Other assets.

Items reducing the deficit:

Items reducing the deficit would include:

- (a) Profits from trading;
- (b) Estimated profit on the realisation of assets.

Notes:

- (a) Where an examination question fails to give you statement of financial position at the date of the receiving order, you should draw up a "rough" statement of financial position to provide the basis for agreeing the deficiency shown in the statement of affairs with that in deficiency account.
- (b) Preparation of the statement of affairs and the deficiency account is based on "double entry" principles.
 - i. Items not in the statement of financial position must have a debit and credit within the statement of affairs and deficiency account.
 - ii. Where the estimated realisable value of an asset differs from its book value i.e. the value at which it appears in the statement of financial position given or computed as in (i) above, the difference must be reflected in the deficiency account.
 - a. An estimated loss is put on the right-hand side;
 - b. An estimated surplus is put on the left-hand side.
 - c. A landlord may recover by distress rent outstanding in respect of the period, not exceeding six months, prior to adjudication (date debtor declared bankrupt). If the landlord distrains he

effectively removes assets to satisfy the outstanding rent and can therefore be considered in the same category as a secured creditor. Do NOT assume distraint unless the question clearly states this course of action. In other cases treat the rent outstanding as an ordinary creditor.

- d. Deferred creditors do not become entitled to any dividend at all until the unsecured creditors have received payment in full; however include them in the unsecured creditors in the Statement of Affairs and put in a note on the Statement of Affairs. If there is any surplus, the deferred creditors will rank against it to the full extent of their debts before any return is made to the debtor. This point is seldom relevant to examination problems.

ACCOUNTS REQUIRED

This can be summarized depending on the nature of the situation. In a receivership you may be required to prepare a receivers receipt and payments. In the process of liquidation you have various reports. They can be summarised as follows:

Pro-forma Statement of Affairs of a Company in Compulsory or Creditors' Voluntary Liquidation

Pro-Forma “Deficiency or Surplus Account”

DEFICIENCY OR SURPLUS ACCOUNT

<u>Items contributing to deficiency (or reducing surplus)</u>	Shs	shs
1) Excess of capital and liabilities over assets 3 years before winding up (if any)		xx
2) Dividends and bonuses declared		xx
3) Net trading losses		xx
4) Losses other than trading losses written off		xx
5) Estimated realization losses		xx
6) Other items contributing to deficiency		xx
		xx
<u>Items reducing deficiency (or contributing to surplus)</u>		
7) Excess of assets over capital and liabilities 3 years before winding up order (if any)	xx	
8) Net trading profits	xx	
9) Profits and income other than trading profits	xx	
10) Other items reducing deficiency or contributing surplus	xx	
	xx	xx
DEFICIENCY AS PER STATEMENT OF AFFAIRS		xx

Tutorial Notes:

Item number 1 above would be represented by a debit balance on the P & L account.

Item number 7 above would be represented by the reserves of the company three years before the winding up order.

Example

A compulsory winding up order was made on 30 November 2003 against Hasara Ltd. A summary of the company's statement of financial position as at that date was as follows:

	Sh. "000"	Sh. "000"	Sh. "000"
Non-current assets:			
Goodwill			
Freehold property			2,689
Plant and machinery			4,940
Shares in subsidiaries			<u>14,620</u>
			22,249
Current assets:			
Stocks		19,180	
Debtors		9,040	
Cash in hand		<u>20</u>	
		28,240	
Current liabilities:			
Bank overdraft	22,790		
Creditors	20,900		
Customs and excise tax	200		
Accruals	399		
Debenture interest due	<u>100</u>	(44,389)	(16,149)
			<u>6,100</u>
Financed by:			
Share capital 5,000,000 ordinary shares of Sh.20 each – fully paid			10,000
400,000 ordinary shares of Sh.20 each- Sh.12.50 paid			<u>5,000</u>
			15,000
Revenue reserves:			
Retained profits (losses)			(12,900)
Shareholders' funds			2,100
Non-current liability:			
10% debentures			<u>4,000</u>
			<u>6,100</u>

Additional information:

- The 10% debentures are secured by a first charge on freehold property and the bank overdraft is secured by a floating charge on the assets.
- The accruals consisted of:

	Sh. "000"
Directors fee, 6 months to 30 November 2003.	75
Managers salary, 2 months to 30 November 2003	80
Wages of 3 workmen, 4 weeks to 30 November 2003	18
Rates – half year to 30 November 2003	20
Taxes for the year to 30 November 2001	120
Miscellaneous expenses	<u>86</u>
	<u>399</u>

- A holder of 20,000 of the partly paid shares was bankrupt and it was anticipated that his trustees would be in a position to pay a dividend of 25% to his unsecured creditors.

4. The company's assets were estimated to be realized as follows:

	Sh. "000"
Freehold property	4,480
Plant and machinery	14,000
Stocks	18,760

5. The debtors were considered to be good except as to Sh. 520,000 of which Sh. 400,000 were doubtful and were expected to realize Sh.110,000. The remaining Sh.120,000 were considered bad. Goodwill was regarded as valueless.
6. Legal proceedings for breach of contract were pending against the company as at 30 November 2003. The company was considered to have a poor defence and attempts were being made to settle the claim out of court for Sh.100,000 plus costs estimated at Sh.80,000. No provision for this claim is included in the statement of financial position.
7. The company had incurred losses of Sh.3,040,000, Sh.3,840,000 and 6,020,000 respectively in each of the three years ended 30 November 2003. The aggregate of the sums charged to the profit and loss accounts during the three years in respect of depreciation, debenture interest and directors' remuneration were Sh.2,380,000, Sh.600,000 and Sh.1,800,000 respectively.

Required:

- (a) Statement of affairs as at 30 November 2003. (10 marks)
- (b) Deficiency account as at 30 November 2003. (10 marks)

(Total: 20 marks)

Solution

HASARA LTD
STATEMENT OF AFFAIRS AS AT 30.11.2003

		Sh.'000'		
Assets not specifically pledged				
Cash in hand		20		
Debtors (8,510 + 110)		8,630		
Stocks		18,760		
Plant and machinery		14,000		
Amounts receivable from calls (2,850 + 25% x 150)		<u>2,887.5</u>		
		44,297.5		
Assets Specifically pledge				
	Estimation realizable Values Sh.'000'	Due to secured Creditors Sh.'000'	Surplus carried to last column Sh.'000'	
Freehold property	4,480	4,100	380	380
Estimated total assets available for preferential creditors, Bank overdraft secured by floating charge and unsecured creditors				44,677.5
<u>Summary of Assets</u>			4,480	
Gross realizable value of assets specifically pledged			<u>44,297.5</u>	
Other assets			<u>48,775</u>	
Gross assets				
<u>Gross Liabilities</u>				
Sh.'000'	<u>Liabilities</u>			
4,100	Secured creditors			
398	Preferential creditors			<u>(356)</u>
				44,321.5
22,790	Bank overdraft secured by floating charge			<u>(22,790.0)</u>
				21,531.5
20,900	Unsecured creditors		20,900	
201	Trade creditors		243	
<u>108</u>	Contingent liability		<u>108</u>	<u>(21,251)</u>
<u>48,497</u>	<u>Estimated Surplus as regards creditors</u>			280.5
	Issued and called up capital 800,000 shares of Sh.20 each			<u>18,000</u>
	Estimated deficiency as regards members			<u>17,719.5</u>

DEFICIENCY ACCOUNT

	Sh.'000'	Sh.'000'
Net trading losses for the three years ended 30 th November 2003 after charging:		(12,900)
Depreciation	2,380	
Debenture interest	600	
Directors' remuneration	<u>1,800</u>	
Estimated losses now written off:		
Goodwill	2,689	
Debtors	410	
Stock	420	
Plant and machinery	620	
Legal claim	108	
Calls in arrears not receivable (20,000 X sh.7.50 X 75%)	112.5	
Freehold property	<u>460</u>	<u>(4,819.5)</u>
		<u>17,719.5</u>

Preferential creditors

	Sh 000
Customs and Excise tax	200
Managers salary (maximum amount)	4
Wages of 3 workment (max 3 X 4000)	12
Rates	20
Taxes	<u>120</u>
	<u>356</u>

Example 2

Filisika Ltd. is insolvent and is in process of filing for relief under the provisions of the Bankruptcy Act. The company has no cash and its statement of financial position currently shows creditors of Sh.48 million. An additional Sh.8 million is owed in connection with various expenses but these amounts have not yet been recorded. The company's assets with an indication of both book value and anticipated net realizable value as at 30 September 1999 as follows:

	Book Value Sh. '000'	Expected NRV Sh. '000'
Land	80,000	75,000
Buildings	90,000	60,000
Accumulated depreciation	(38,000)	-
Equipment	110,000	20,000
Accumulated depreciation	(61,000)	-
Investments	10,000	18,000
Stocks	48,000	36,000
Debtors	31,000	9,000
Other assets	<u>5,000</u>	<u>-</u>
	<u>275,000</u>	<u>218,000</u>

Additional information:

1. Filisika Ltd. has three debentures payable, each with a different maturity date:

- Debentures one due in 5 years – Sh.120 million, secured by a mortgage lien on Filisika's land and buildings.
 - Debenture two due in 8 years – Sh.30 million secured by Filisika's investments.
 - Debenture three due in 10 years – Sh.35 million, unsecured.
2. Of the creditors owed by Filisika Ltd. Sh.10 million represents salaries to employees. However, no individual is entitled to receive more than Sh.4,000. An additional Sh.3 million is included in this liability item that is due to the Kenya Government in connection with taxes.
 3. The shareholders equity balance reported by the company at the current date is Sh.42 million: composed of ordinary share capital of Sh.140 million and a deficit of Sh.98 million.
 4. If the company is liquidated, administrative expenses of approximately Sh.20 million would be incurred.

Required:

A statement of affairs and deficiency or surplus account for Filisika Ltd. to indicate the expected availability of funds if the company is liquidated as at 30 September 1999.

Solution**FILISIKA LTD
STATEMENT OF AFFAIRS AS AT 30.09.99**

					Sh.'000'
Assets					
Unpledged Assets					20,000
Equipment					3,600
Stock					9,000
Debtors					<u>-</u>
Others					65,000
Pledged Assets					
Assets	NRV	Liability	Surplus	Deficit	
Land & buildings	135,000	120,000	15,000	-	
Investments	<u>18,000</u>	<u>30,000</u>	<u>-</u>	<u>12,000</u>	
	<u>153,000</u>	<u>150,000</u>	<u>15,000</u>	<u>12,000</u>	<u>15,000</u>
Surplus on pledged assets					80,000
Total assets for creditors and members					
Gross Assets		Sh.'000'			
Pledged		153,000			
Unpledged		<u>65,000</u>			
		<u>218,000</u>			
Gross liabilities	Liabilities				
150,000	Secured creditors				
	<u>Preferential creditors</u>				
20,000	Administrative expenses				(20,000)
10,000	Salaries to employees				(10,000)
3,000	Government taxes				<u>(3,000)</u>
					47,000
	<u>Unsecured creditors</u>				
35,000	Creditors			35,000	
35,000	Debentures			35,000	
<u>8,000</u>	Accrued expenses			8,000	
261,000	Deficit on secured creditors			<u>12,000</u>	<u>(90,000)</u>
	Deficiency to unsecured creditors				(43,000)
	Ordinary share capital				<u>(140,000)</u>
	Estimated deficiency as regards to members				<u>183,000</u>

RE: FILISIKA LTD
DEFICIENCY A/C FOR THE YEAR ENDED 30.09.99

	Sh.'000'	Sh.'000'
Items contributory to deficiency		
Accumulated trading losses		(98,000)
Omitted accrued expenses		(8,000)
Administrative expenses		(20,000)
		(126,000)
<u>Estimated losses on realization</u>		
Land	50,000	
Equipment	29,000	
Stock	12,000	
Debtors	22,000	
Other assets	<u>5,000</u>	(73,000)
		(199,000)
<u>Items reducing deficiency</u>		
<u>Estimated surplus on realization</u>		
Buildings	8,000	
Investments	<u>8,000</u>	<u>16,000</u>
Deficiency as per SOA		183,000

Pro-Forma Statement of Assets and Liabilities (For use in members' voluntary liquidation)

STATEMENT OF ASSETS AND LIABILITIES

	Estimated to realize or to rank for payment	
		Sh
<u>Assets</u>		
Balance at bank		xx
Marketable securities		xx
Trade debtors		xx
Stocks and work-in-progress		xx
Freehold and leasehold property		xx
Plant and machinery		xx
		xx
<u>Liabilities</u>		
Secured on specific assets	xx	
Secured by a floating charge	xx	
Estimated costs of liquidation	xx	
	xx	
Unsecured creditors	xx	
Bills payable and other liabilities	xx	xx
ESTIMATED SURPLUS AFTER PAYING DEBTS IN FULL		xx

This is rarely examined and therefore no examples are available.

RECEIPTS AND PAYMENTS ACCOUNTS

This is a straight forward receipts and payments account but does not necessarily deal only with cash since the receiver may receive stocks, shares etc in satisfaction for company assets he has sold, and distribute these.

RECEIVER'S RECEIPTS AND PAYMENTS ACCOUNT			
	Shs		Shs
Bank balance taken over	xx	Cost of realizations	xx
Sales of pledged assets	xx	Receiver's remuneration	xx
		Preferential creditors (where the Secured creditors are secured By a floating charge)*	xx
		Creditors secured by the pledged Assets (Fixed charge) taken over	xx
		Balance transferred to liquidator	xx
	xx		xx
	xx		xx

LIQUIDATOR'S RECEIPTS AND PAYMENTS ACCOUNT			
	Shs		Shs
Balance from receiver	xx	Cost of liquidation	xx
Sales of assets	xx	Liquidator's remuneration:	
Calls on shareholders	xx	- % of amounts realized on sale of assets	xx
		- % of distribution to unsecured creditors and members	xx
		Preferential creditors (if unpaid by receiver)*	xx
		Unsecured creditors	xx
		Preference shareholders	xx
		Ordinary shareholders	xx
	xx		xx
	xx		xx

*If the receiver was appointed by creditors secured by a floating charge, he must settle preferential creditors before paying such secured creditors.

If the receiver was appointed by creditors secured by a fixed charge, he will directly settle the creditors who appointed him – and therefore preferential creditors must be paid by the liquidator (if liquidation is to take place).

The receivers' and liquidators receipt and payments can be presented in vertical formats.

Example

- (a) List and explain briefly the powers of liquidator (5 marks)
- (b) Hasara Ltd makes its accounts each year 31 October and has been trading at a loss. On 31 October 2002, a resolution for a voluntary liquidation was passed. The statement of financial position as at that date was as follows.

	Sh. '000'	Sh. '000'	Sh. '000'
Non Current assets			11,000
Freehold property			<u>2,750</u>
Plant and machinery			13,750
		8,750	
Current assets:		13,375	
Stock		<u>125</u>	
Debtors		22,250	
Cash	3,750		
	11,250		
Current liabilities:			
Bank overdraft	<u>500</u>	(15,500)	<u>6,750</u>
Creditors			<u>20,500</u>
Interest payable (5% debentures)			
Paid up capital:			
10,000 10% cumulative preference shares of Sh.500 each fully paid			5,000
25,000 Ordinary shares of Sh.500 each fully paid			12,500
10,000 Ordinary shares of Sh.500 each. Sh.250 paid.			<u>2,500</u>
			20,000
Revenue reserves: profit and loss account			(9,500)
Non Current liabilities:			<u>10,000</u>
5% debentures			<u>20,500</u>

Additional information:

1. The debentures are secured by a floating charge on the asset and undertaking of the company.
2. The bank overdraft is secured by a fixed charge on the company's freehold property.

3. The preference shares carry a right to a fixed cumulative dividend of 10% per annum up to the date of liquidation and a repayment of Sh.500 per share in priority to all other classes of shares. No dividend has been paid on the preference shares for two years.
4. The creditors include:

	Sh. '000'
Directors fees for one year	1,000
Rates for six months to 31 October 2002	125
Manager's salary for October 2002	
Wages for 15 employees	
Pay As You Earn (PAYE)	

5. The assets realized the following amounts:
- | | |
|---------------------|--------|
| Freehold property | 12,500 |
| Plant and machinery | 2,000 |
| Stock | 6,250 |
| Debtors | 12,250 |
6. The expenses of liquidation amount to Sh.125,000 and the liquidator's remuneration was fixed at Sh.500,000.

Required:

The liquidator's statement of account showing in order of priority, the payments made and the computation of any calls to be made.

Solution

(a) **Powers of a liquidator**

Under section 241 of the Companies Act the liquidator has some powers some of which are exercisable with the consent of the court or a committee of inspection while others are exercisable without consent.

Powers exercisable with consent

- To blame or defend any action or other legal proceedings in the name and on behalf of the company.
- To carry on the business of the company in so far as may be necessary for beneficial winding up.
- To appoint an advocate to assist in the performance of his duties
- To pay any class of creditors in full
- To make any compromises or arrangement with creditors
- To compromise all calls, liabilities to calls debts. And other liabilities.

Powers exercisable without consent

- To sell any movable or immovable properties of the company
- To execute deeds and other documents in the name of the company and on its behalf
- To prove rank and claim in the bankruptcy or insolvency of a contributory

- To draw, accept or endorse any of exchange, a promissory note in the name of a company.
- Raise money on the security of the company's assets
- Appoint an agent to do business which he can not do himself
- Do all such other things as are necessary for the winding up of a company and distributing its assets.

(b)

Hasara Ltd
Liquidators Statement of Account

	Sh.		Sh.
<u>Sales of pledged assets</u>		Cost & charges (W2)	625
Freehold property	12,500	Preferential creditors (W1)	504
Bank overdraft	(3,750)	Floating charge – Debentures	10,000
		- Interest	500
			10,500
<u>Sale of unpledged assets</u>		Unsecured creditors (11,250 –	10,746
Plant and machinery	2,000	540)	
Stock	6,250	Preferential share holders:	5,000
Debtors	12,250	Capital	1,000
Cash	125	Dividend	6,000
Calls made (150 x 10,000) (W3)	<u>1,500</u>	(10% x 5000 x 2)	<u>2,500</u>
		Ordinary shareholders (25,000 x	
		100)	
	<u>30,875</u>		<u>30,875</u>

WORKINGS

1. **Preferential creditors:**

Rates 6 months to 31.10.02	125
Managers salary (max)	<u>4</u>
	129
Wages for 15 employees	50
PAYE	<u>325</u>
	<u>504</u>

2. **Cost & charges:**

	125
Liquidation expenses	<u>500</u>
Liquidator's remuneration	<u>625</u>

3. **Determination of calls (if any)**

	1,000
Calls available	<u>2,500</u>
Notional calls (250 x 10,000)	<u>3,500</u>
	35
No. of shares (25 + 10)	<u>3,500</u> = 100
Notional distribution	35
Calls made	250 – 100 = 150

Example 2

Nagala supermarket Ltd. deals in imported goods which are paid for in foreign exchange. Following the recent depreciation of the Kenyan shilling the company has incurred exchange losses on trade

debtors and its business has become generally uncompetitive and consequently forcing the company into a voluntary liquidation on 1 November 1997:

As at 1 November 1997:

1. The company had a bank loan of Sh.625,000 which was secured on furniture and fittings. The furniture and fittings realised Sh.1,000,000.
2. Assets not specifically pledged realised Sh.4,250,000.
3. Liquidation expenses amounted to Sh.187,500.
4. Salaries payable to messengers for the last three months amounted to Sh.22,500, Sh.60,000 was four months salary payable to clerks.
5. Unsecured trade creditors were Sh.1,092,500.
6. The share capital comprised of 10,000 8% preference shares of Sh.100 each and 25,000 ordinary shares of Sh.100 each.
7. Calls in arrears were:
 - Sh.25 on 10,000 ordinary shares
 - : Sh.40 on 8,000 ordinary shares
 - : Sh.50 on 7,000 ordinary shares

Required:

The liquidator's statement of receipts and payments with the appropriate support schedule (15 marks)

Solution

RE: Nagala Supermarket Ltd

Liquidators statement of receipts and payments

	Shs.		Shs.
Proceeds from sale of furniture		Expenses of liquidation	187,500
And fittings	1,000,000	Preferential creditors paid	
Repayment of bank loan	(625,000)	Salaries to messengers	22,500
Proceeds from sale of assets		Salaries to clerks	60,000
Not specifically pledged	4,250,000		
		Unsecured creditors Paid	
		Trade creditors	1,092,500
		Share capital repaid	
		Preference shareholders	1,000,000
		Ordinary shareholders	1,580,000
			2,580,000
		Dividend to ord shareholders	<u>682,500</u>
	<u>4,625,000</u>		<u>4,625,000</u>

Schedule of repayments to shareholders

Div	Issued	Paid up	Calls in	Gross	Net	Surplus
Per Sha	S capital	S capital	Arrears	Rep.	Rep	
Shs.	Shs	Shs	Shs	Shs	Shs	Shs
8% pref.S cap	1,000,000	1,000,000		1,000,000	1,000,000	-
-						
10000 Ord Sh	1,000,000	750,000	250,000	1,000,000	750,000	323,972
32.40						
8000 Ord Sh	800,000	480,000	320,000	800,000	480,000	207,342
25.90						
7000 Ord. Sh	<u>700,000</u>	<u>350,000</u>	<u>350,000</u>	<u>700,000</u>	<u>350,000</u>	<u>151,186</u>
<u>21.60</u>						
	<u>3,500,000</u>	<u>2,580,000</u>	<u>920,000</u>	<u>3,500,000</u>	<u>2,580,000</u>	<u>682,500</u>
<u>N/A</u>						
Available cash			<u>3,262,500</u>			
Total repayments			<u>4,182,500</u>			

Tutorial notes:

- 1) Since the total repayments (Sh4182500) is in excess of the issued share capital (Sh3500000) the issued share capital may be returned in full to the shareholders, less of course, any calls expected from them. This meant a return to shareholders of Shs2580000. The surplus of Sh682500 (Sh3262500 – Sh2580000) is given only to the ordinary shareholders as a dividend.
- 2) It is assumed that all the messengers and clerks are owed a maximum of Sh4000 per person per month.
- 3) It is also assumed that the preference dividends are paid up to date and the company's articles of association are based on Table A i.e dividends payable to shareholders is based on paid up share capital and not issued share capital.

OSC 1st lot): $750000/1580000 \times 682500 = 323972$

OSC 2nd lot): $480000/1580000 \times 682500 = 207342$

OSC 3rd lot): $350000/1580000 \times 682500 = 151185$

REINFORCING QUESTIONS

QUESTION ONE

Chege, a trader, filed his own petition in bankruptcy. The statement of financial position of his business as on

30th June 20X1, the date of the Receiving Order, showed:

	Kshs		Kshs	Net Realisable Value Kshs
	000'		000'	000'
Capital Account as on 1 st July 2000	600	Freehold shop building	1,200	1,400
Add: Profit for year to 30 th June 20X1	<u>200</u>	10,000 shares of Shs 100 each at cost in Ivory Ventures Ltd	1,000	20
	800			
Deduct: drawings in year 30 th June 20X1	180	Stock	400	300
	620	Trade Debtors	450	350
Trade Creditors (including Shs.50,000 Preferential in bankruptcy)	1,680	Balance at Bank	50	50
Loan, secured on freehold shop building	<u>800</u>			
	<u>3,100</u>		<u>3,100</u>	

Chege's personal assets, not included above, comprised of a motor car valued at Shs. 20,000, a current account with his bank of Shs.40,000 and a gold watch valued at Shs.50,000. His personal liabilities outside the business were Shs.6,000 due to his butcher and Shs.10,000 for unsuccessful horse-racing forecasts due to his bookmaker.

The value of personal assets and liabilities had remained unchanged since 1st July 20X0.

In 20V9 (i.e. 12 years previously), Chege had made a voluntary settlement of Shs.200,000 in favour of his invalid sister, Mary.

You are required to prepare, as on 30th June 20X1:

- (a) A Statement of Affairs, and
(b) A Deficiency Account. (15 Marks)

QUESTION TWO

Wanja and Juma, who trade in partnership, find themselves unable to meet their obligations and instruct you to prepare a Statement of Affairs for submission to a meeting of creditors.

You are able to ascertain the following particulars from the books as at 1st November 20X1:

	Shs '000
Unsecured creditors	1,200
Loan from Kuria	100
Creditors partly secured	230
Estimated value of security	200

Preferential claims	14
Stock-in-Trade (at cost)	100
Cash in Bank	35
Cash in Hand	12
Fixtures	100
Debtors Good	140
Debtors Bad	40
Debtors Doubtful	50

There was an excess of assets over liabilities at 1st January 20X8, of Shs.216,000, but since that date there has been a loss on trading of Shs.784,400. Partners drawings from 1st January 20X0 to 1st November 20X1 amounted to Shs.298,600. Juma is a limited partner who brought in capital of Shs 100,000. Wanja is a general partner, whose separate estate has been entirely absorbed in financing the business. The loan from Kuria was made under an agreement by which he was to receive interest at a rate varying with the profits.

For the purpose of the Statement of Affairs it was estimated that stock would realise Shs.85,000 and fixtures Shs.10,000 while doubtful debts would produce Shs.10,000.

Add such explanatory notes to the Statement as are necessary to convey to creditors the true position of affairs.
(Total: 20 marks)

QUESTION THREE

Rucha and Mambo are in partnership trading as Ruma and they present their petition in Bankruptcy. The following statements have been presented to you and you are asked to prepare the Statement of Affairs and Deficiency Accounts of the Joint and Separate estates.

	Ruma Shs'000	Rucha Shs'000	Mambo Shs'000		Ruma Shs'000	Rucha Shs'000	Mambo Shs'000
Mortgage on Free- Hold Property	2,250	1,600		Freehold Property	3,000	2,000	
Bank Overdraft	1,500			Plant	1,000		
Sundry Creditors	8,750	400	1,350	Furniture etc.	500	600	700
Capital – Rucha	500			Stock	3,000		
-	500			Debtors	6,000		
Mambo				Partnership and Other investments			
Surplus	<u>13,500</u>	<u>1,500</u>	<u>150</u>		<u>13,500</u>	<u>900</u>	<u>800</u>
		<u>3,500</u>	<u>1,500</u>			<u>3,500</u>	<u>1,500</u>

The bank overdraft was secured by a second mortgage on the freehold property and by the deposit of Rucha's investments and his personal guarantee.

The estimated realisable value of the assets was as follows:

Ruma	Rucha Shs '000	Mambo Shs '000	Shs '000
Freehold property	3,250	2,350	
Plant	400		
Furniture etc	200	400	550
Stock	2,150		
Debtors, Good	2,500		
Doubtful, estimated Kshs.12 in KKshs.1 recoverable	1,500		
Bad	1,000		
Investments		850	650
Of the sundry creditors the following amounts			
Were preferential	250	100	50

(Total: 20 marks)

QUESTION FOUR

The Nyamole Company Ltd.'s unaudited Statement of financial position as at 31st July, 20X1 is shown below:

Assets:	Shs.	Shs.
Land	130,000	
Buildings less accumulated depreciation	900,000	
Machinery less accumulated depreciation	1,200,000	
Goodwill	<u>200,000</u>	2,430,000
Current Assets:		
Cash	120,000	
Debtors and prepayments	950,000	
Investments	200,000	
Stock – Finished goods	600,000	
- Raw materials	<u>400,000</u>	
	<u>2,270,000</u>	
Current Liabilities:		
Creditors	942,000	
Accrued Wages	150,000	
Other payables	<u>1,350,000</u>	
	<u>2,442,000</u>	
Net Current Liabilities		72,000
		<u>2,258,000</u>
Financed by:		
Share capital		1,000,000
Mortgage payable		1,300,000
Profit and Loss Account		<u>(42,000)</u>
		<u>2,258,000</u>

The following additional information is available:

1. The company is facing bankruptcy proceedings.
2. Cash includes a Sh.5,000 travel advance which has been spent.

3. Debtors and prepayments of Sh.400,000 have been pledged in support of other payables in the amount of Sh.300,000. Debit balances of Sh.50,000 are to be netted in the debtors and prepayments total on account of being bad debts
4. Investments consist of Treasury Bills costing Sh.100,000 and 500 ordinary shares of Osense Company shares. The market value of the Treasury bills is Shs 100,000 and the market value of the shares is Shs 18 per share. The investments are collateral for a bank loan of shs.200,000 included in other payables.
5. The creditors balances include accrued interest on mortgages of Shs 2,000.
6. The investments are collateral for a Shs 200,000 loan payable to the bank. The bank
7. loan is included in the other Payables balance.
8. Estimated realizable value of finished goods is Shs 500,000 and of raw material is Shs 300,000. For additional out-of-pocket costs of Shs 100,000 the raw materials would realize Shs 599,000 as finished goods.
9. The market value of Land, Buildings and Machinery is as follows: Land - Shs 250,000: Buildings - Shs 1,100,000: Machinery — Sh.650,000
10. Creditors include Sh.150,000 P.A.Y.E. deductions and Sh.60,000 due to the creditors who have been reassured by the Managing Director that they would be paid. There are unrecorded P.A.Y.E. deductions amounting to Sh.5,000.
11. Mortgages payable consist of Sh.1,000,000 on Land and Buildings and Sh.300,000 in connection with a hire purchase agreement on machinery. Total unrecorded interest for these liabilities amounts to Sh.24,000. interest on land and buildings mortgage is Shs 20,000 while that of the machinery mortgage is shs.6,000
12. Probable judgement on a pending damage suit is estimated at Sh.500,000.
13. Expenses in connection with the liquidation are estimated at Sh.100,000.
14. The auditors have not submitted a fee note for Sh.50,000 in connection with the annual audit for the year ended 30th April, 20X1.
15. The receiver estimates the liquidation work to cost Sh.10,000.

Required:

- (a) A Statement of Affairs for Nyamole Company Ltd. as at 31st July, 20X1. (18 Marks)
- (b) A Deficiency Account of Nyamole Company Ltd. in respect of unsecured creditors. (7 Marks)

(Total: 25**Marks)****QUESTION FIVE**

- a. In the bankruptcy of Mr. A, the trustee, having obtained the consent of the committee of inspection, has decided to make a first dividend payment to unsecured creditors. Details of the bankruptcy transactions to date are as follows:

	Shs'000
Business receipts, less payments	1,250
Payments to preferential creditors	340
Court fees and taxed costs	255
Proceeds of sale of assets (including business)	
(gross)	5,300
Auctioneer's fee for sale of assets	300

Assets remaining unsold are estimated to realise Shs.2,760,000. Unsecured creditors (non-preferential) have claims amounting to Shs.10m.

The trustee's remuneration has been agreed at:

- i. 4% on realisations;
- ii. 8% on dividends to unsecured creditors.

On the assumption that the trustee wishes to retain at least Shs 75,000 (to cover outgoings), prepare the statement which is required to accompany the dividend payment. (8 Marks)

- b. Later, the trustee realizes the remaining assets for Shs. 2,450,000 (gross), and agents' fees and other outgoings (excluding the trustee's remuneration) total Shs. 160,000. The trustee now wishes to obtain his discharge. Prepare the summary of the trustee's cash book giving details of the receipts and payments for the whole trustship (including the final dividend paid to creditors). (7 Marks)

CHECK YOUR ANSWERS WITH THOSE GIVEN IN LESSON 9 OF THE STUDY PACK

LESSON SIX

EXECUTORSHIP LAW AND ACCOUNTS

OBJECTIVES

At the end of this lesson, you should:

- Know the provisions of the law of succession;
- Know how to prepare the accounts of executors and administrators of the estate of deceased persons.

CONTENTS

- Read the study text below.
- Attempt reinforcing questions at the end of the lesson.
- Compare your solutions with those given in Lesson 9.

STUDY TEXT

EXECUTORSHIP LAW: THE LAW OF SUCCESSION

7.1 EXECUTORSHIP

Executorship is the body of statute law, case law and practice concerning the management of the estate of a deceased person. In what follows, we shall express the law as applying to a masculine person, but it applies equally to women, whether married or not.

When a person dies, he dies:-

- (a) **TESTATE** — he leaves a valid will, which disposes of all his free property (i.e the property of which he was legally competent to dispose during his lifetime, and in respect of which his interest does not terminate by his death)

OR

- (b) **INTESTATE** — he does not leave a valid will, or the will does not dispose of all his free property.

Since the vast majority of people in Kenya die intestate i.e. without leaving a will, we will deal with this situation first.

7.2 DISTRIBUTION UNDER THE INTESTACY PROVISIONS

When a person dies without leaving a will, his estate is distributed according to the Law of Succession Act.

When a person dies, four situations can be distinguished:

1. The intestate leaves no spouse and no children;
2. The intestate leaves no spouse but children;
3. The intestate leaves one surviving spouse, but no children;
4. The intestate leaves one spouse and children (or in the case of a male intestate who married under any system of law which permits polygamy, a number of wives and children).

The rules of intestacy:

Agricultural land, crops and livestock in certain areas of Kenya are not covered by these rules; they are distributed according to the law or custom of the tribe or community to which the deceased belonged.

(a) The intestate leaves no spouse and no children

The net estate devolves as follows: to his

1. Father; or if dead
2. Mother; or if dead
3. Brothers and sisters, and any child or children of deceased brothers and sisters, in equal shares; or if none
4. Half—brothers and half—sisters and any child or children of deceased half—brothers and half—sisters, in equal shares; or if none
5. Relatives who are in the nearest degree of consanguinity up to and including the sixth degree, in equal shares; or if none
6. The Consolidated Fund of the Government.

Example;

A dies intestate; he never married. His father and brother have pre-deceased (i.e. died before) him.

A is survived by his brothers C and D, and sisters E and F; his brother B pre-deceased him, but left a wife K and children L and M. His net estate was worth Shs. 3m. How will it be divided on his death?

His brothers and sisters and the children of his deceased brother receive equal shares i.e. C, D, E, F, L and M each receive Shs.500,000, to give a total of Shs.3m.

Note

Section 39(1)(c) of the Law of Succession Act (on which this example is based) is not in accordance with recommendation No. 41 of the Report of the Commission on the Law of Succession; whether the difference is intentional or accidental is difficult to say.

(b) The intestate leaves no spouse but children

The net estate devolves upon the surviving children and is divided equally between them. If any child has not, at the time of intestate's death, reached his majority, his share of property will be held in trust until he reaches the age of 18 years, or, in the case of a female until she marries under that age.

Example

Mr A dies intestate; his wife Mrs A died some years ago. Mr A is survived by his sons B (22 years old) and C (18 years only). His daughter is at school; she is not yet married. His net estate is worth Shs.3m. How will his property be divided?

It will be divided equally between B, C and D. D's share will be held in trust (see Chapter 8) until she reaches the age of 18 years, or until she marries, if she marries before she reaches the age of 18.

If a child of the deceased intestate predeceases him, but leaves his or her own issue (i.e. children, grandchildren, etc.), then the issue take, through degrees, in equal shares, the share which their parent would have taken had he not pre-deceased the intestate (**PER STIRPES RULE**).

Example

Mr K dies intestate; his wife Mrs K died two weeks before Mr K. Mr K's eldest son, M, died some years ago; M's children P, Q and R are alive at the time of Mr K's death. B, C and D, Mr K's other children were all alive when Mr K died. His net estate is worth Shs.3.6m; how will it be divided?

B, C and D will each receive one quarter of the estate i.e. Shs.900,000 each. If M had been alive he would also have received Shs 900,000. Since M predeceased his father, but left issue alive at the time of his father's death, his children will share the Shs.900,000 equally i.e. P, Q and R will each receive Shs.300,000.

If the intestate during his life—time or by will paid to, gave to or settled any property on a child, grandchild or house, that property shall be taken into account in determining the share of the net intestate estate finally accruing to the child, grandchild or house.

Example

Mr K dies intestate, his wife and eldest son J having predeceased him. Mr K is survived by A and B the son and daughter of this eldest son J, and his own sons M and N. During Mr. K's life—time, he (Mr. K) had made gifts of Shs.1m. to N, and Shs 500,000 to B. Mr. K left net estate worth Shs.5m: How would it be divided?

		Total Shs m	J Shs m	M Shs m m	N Shs m
Mr. K	Net Estate	5			
	Add:				
	Advancement				
	To N	<u>1</u>			
	Total	6	2	2	2
	Deduct:				
	Advancement	<u>(1)</u>	-	-	<u>(1)</u>
		5	2	2	1
				A	B
	Add:				
	Advancement				
	To B		<u>0.5</u>		
	Total		2.5	1.25	
			1.25		
	Deduct:				
	Advancement		<u>(0.5)</u>	—	<u>(0.5)</u>
			<u>2.0</u>	<u>1.25</u>	<u>0.75</u>

(c) **The intestate leaves one surviving spouse, but no child or children.**

The surviving spouse is entitled to:

1. The personal and household effects of the deceased absolutely: "personal and household effects" are: clothing and articles of personal use and adornment, furniture, appliances, pictures, ornaments, food, drink, utensils and all other articles of household use or decoration normally to be associated with a matrimonial home, but not any motor vehicle or any other thing connected with the business or profession of the deceased; and
2. The first Shs.10,000 out of the residue of the net intestate estate, or 20% thereof, whichever is the greater; and
3. A life interest in the whole of the remainder; if the surviving spouse is a widow, this life interest ceases upon her re—marriage to any person. When the spouse dies (or re—marries, if a widow), the property subject to the life interest devolves in the order of (a) above.

(d)

1. The intestate leaves one surviving spouse and children

The surviving spouse is entitled to:

- a. The personal and household effects of the deceased absolutely;
 - b. A life interest in the whole residue of the net intestate; if the surviving spouse is widow, this interest ceases upon her re—marriage to any other person. On the death of the surviving spouse (or on her re—marriage if she is a widow), the residue of the net intestate estate is equally divided among the children alive at the moment of death (or re—marriage) of the surviving spouse.
- 2. The intestate leaves several wives, married under any system of law which permits polygamy**

His personal and household effects and the residue of the net intestate estate shall first be divided among the houses ("house" means family unit, comprising a wife, whether alive or dead at the date of death of the husband, and the children of that wife) according to the number of children in each house, but also adding any wife surviving him as an additional unit to the number of children. The personal and household effects and the residue of the net intestate estate are distributed within each house as above.

Example

Mr O dies intestate, leaving two wives, A and C whom he married under a system of law which permits polygamy; a third wife B had predeceased him. A has children P, Q and R; B had children S and T; C has no children.

All the children are alive at the time of Mr O's death. The value of his personal and household effects was Shs.700,000 and the value of the net residue of the estate was Shs.2,800,000. How should his estate be divided?

House	1	2	3	
	Total(units)			
Wife	A	B(dead)	C	2 units
Children	P:Q:R	S:T	NONE	5 units 7 units

To wife absolutely:

1.	Personal and household effects	4/7 x Shs 700,000 = Shs 400,000	N/A	1/7 x Shs 700,000 = Shs 100,000
2.	20% of the Residue	N/A	N/A 20%	1/7 x Shs 2.8m x = Shs 80,000
	Wife's life interest in the whole residue or remainder	4/7 x Shs 2.8m = Shs 1.6m	N/A	1/7 x Shs 2.8m - Shs 80,000 = Shs 320,000

To be shared between S and T absolutely:

Personal and household effects	N/A	S:Shs 100,000 T:Shs <u>100,000</u> Shs <u>200,000</u>	N/A
Residue	N/A	S:Shs 400,000 T:Shs <u>400,000</u> Shs <u>800,000</u>	N/A

Example**WILLS****Definition:**

A will is the legal declaration by a person of his wishes or intentions regarding the disposition of his property after his death, duly made and executed according to the provision of the Law of Succession Act.

Requirements of a valid will:

1. In order to make a will, a person must be of sound mind and have reached his majority.
2. A person may dispose of all or any of his free property by will and may make any disposition by reference to any secular or religious law that he chooses.
3. A female person (whether married or not) has the same capacity to make a will as a male.
4. When a person makes or purports to make a will, he shall be deemed to be of sound mind unless, at the time of executing the will, he is in such a state of mind, whether arising from mental or physical illness, drunkenness or from any other cause, as not to know what he is doing. The burden of proof that a testator (i.e. the person who makes the will) was, at the time, not of sound mind, shall be upon the person who so alleges.
5. A person may, by will, appoint an executor or executors. An executor is a person to whom the execution of the last will of a deceased person is, by the testator's appointment, confided.
6. If a will, or any part of a will, was made by fraud or coercion, or by such importunity as takes away the free agency of the testator, or has been induced by mistake, the will, or that part of it, is void.
7. A will may be made:

Orally; it will not be valid unless:

1. It is made before two or more competent witnesses (i.e. persons of sound mind and full age); and
2. The testator dies within 3 months of the date of making the will;
3. An oral will made by a member of the armed forces or merchant marine during a period of active service (i.e. service on a field of military operations or at sea, or proceeding to or from, or under orders to proceed to, or being in some place for the purpose of proceeding to, a field of military operations or sea) is valid for more than three months after the date of making the will, provided he dies in the same period of active service.
4. If an oral will is made after a written will has not been revoked, the oral will is not valid in so far as it is contrary to the written will; if a written will is made after an oral will, the written will be the valid will (unless some property disposed of by the oral will is not disposed of by the written will.)
5. If there is any conflict in evidence of witnesses as to what was said by the deceased in making an oral will, the oral will is not valid except so far as its contents are proved by a competent independent witness (an independent witness is one who is not a beneficiary or the spouse of a beneficiary under a will).

In writing: a written will is not valid unless it fulfills the following conditions.

1. The testator must sign the will; or he must affix his mark to the will (i.e. affix his thumbprint or his stamp or his ring—mark); or the will must be signed by some other person in the presence and by the direction of the testator (The testator must have animus testandi i.e. the desire to make a will).
2. The signature or mark of the testator, or the signature of the person signing for him, must be so placed that it shall appear that it was intended thereby to give effect to the writing as a will. (Normally the signature or mark should be put at the foot of the will).
3. The will must be attested by two or more competent witnesses, each of whom must have seen (they cannot therefore be blind) the testator sign or affix his mark to the will, or have seen some other person sign the will in the presence and by the direction of the testator, or have received from the testator a personal acknowledgement of his signature or mark, or of the signature of that other person. Each of the witnesses must sign the will in the presence of the testator. It is not necessary that more than one witness be present at the same time, and no particular form of attestation is necessary.
4. A testator may refer in a will or codicil (a codicil is a testamentary instrument made in relation to a will, explaining, altering or adding to its dispositions or appointment; it must be made in accordance with the provision laid down for a written will) to another document then actually written which expresses any part of his intention. If this document is clearly identified as the document to which the will refers, it shall be considered as forming part of the will or codicil in which it is referred to.
5. If one of the persons attesting the will or his spouse, is also a beneficiary of the will, or is appointed executor in the will, the will is valid as to the number of witnesses. However, a bequest to an attesting witness (including any direction as to payment of costs or charges) or a bequest to his or her spouse shall be void unless the will is also attested by at least two additional competent independent witnesses, in which case the bequest shall be valid.
6. If a person is appointed an executor of a will, he is not thereby disqualified as a witness to prove the execution of the will or to prove its validity or invalidity.
7. A will, drawn up in a foreign country in accordance with the laws of the country, shall be deemed to be valid in Kenya, even though it is not drawn up as above; it is valid to property in that country; it is valid if the testator is a national of that country, either at the time the will was made, or at the time of his death.

(h) **Revocation, alteration and revival of a will**

1. A will may be revoked or altered by the maker of it at any time when he is competent to dispose of his free property by will. (A will is said to be ambulatory).
2. A will is revoked by the later marriage of the maker, unless the will is expressed to be made in contemplation of marriage with a specific person (and the subsequent marriage is to that person).
3. A will or codicil, or any part of it, can be revoked only by making another will or codicil declaring an intention to revoke it, or by burning, tearing or otherwise destroying the will with the intention of revoking it by the testator, or some other person at his direction, or by subsequent marriage as in (ii) above.
4. A written will can never be revoked by an oral will.
5. No obliteration, interlineation or other alteration made in a written will after the execution of it (signed by the testator and witnesses) shall have any effect unless the alteration is signed and attested as required for a will. If a will is so altered, then the will is deemed to be duly executed if the signature of the testator and the subscription of the witnesses is made in the margin or on another part of the will opposite or near to the alteration, or is referred to in a memorandum written at the end or some other part of the will and is so signed and attested.
6. Where a typewritten or printed will purports to have been executed by the filling in of any blank spaces, there shall be a presumption that the will has been duly executed.

A will which has been wholly revoked in any manner cannot be revived except by re—executing the will. Where any part of the will has been revoked, that part shall not be revived otherwise than the re—execution of that part, or by a subsequent will or codicil showing an intention to revive it.

7.2.1 Characteristics of a will:

- (a) **Dispositional:** A will disposes the deceased's property.
- (b) **Formality:** For a will to be valid, it must be written and signed by the deceased and appropriate witnesses. Oral wills are only valid if the testator dies within three months of making the will.
- (c) **Alterations:** Alterations to the will e.g. in form of codicils, need to be signed and witnessed appropriately.
- (d) **Posts-humous effect:** A will only takes effect after the testator is dead. Thus, it is often said that a will is a device through which the dead can rule the living from their graves.
- (e) **Capacity:** The testator must have the capacity to make a will at the time that he makes the will e.g. he must be of sound mind.
- (f) **Legality:** The will must be legal for it to be upheld in law.

7.3 TYPES OF GIFT BY WAY OF A WILL

- (a) A special (or specific) legacy is a testamentary gift of a particular part of the property of the testator, which identifies that part by a sufficient description, whether in specific or in general terms and manifests an intention that that part shall be enjoyed as taken in the state and condition indicated by the description.

E.g. I leave my house in Buru Buru, Nairobi, to my eldest son Maina.

- (b) A general legacy is a testamentary gift, whether specific or general, of property described in general terms to be provided out of the general estate of the testator, whether or not also charged on any specific part of his estate. A pecuniary legacy includes an annuity, a general legacy, a demonstrative legacy so far as it is not discharged out of the specified fund or property and any other general direction by the testator for the payment of money, including all death duties free from which any gift is made to take effect.

- E.g.
1. I leave Shs 200,000 to my youngest daughter June.
 2. I leave a bicycle to my son Juma (NOT MY bicycle NOR THE bicycle, but a bicycle).

- (c) A demonstrative legacy is a testamentary gift which is in its nature general but which manifests an intention that the gift shall be primarily satisfied out of a specified fund or a specified part of the property of the testator, but shall, upon failure of that fund or property, be met from the general estate.

Example

A leaves Shs 100,000 to B payable out of his holding of ordinary shares in Kenya Breweries Limited.

If A owns ordinary shares in Kenya Breweries Limited at the time of his death, the gift of Shs 100,000 is deemed to be a specific legacy. If no Kenya Breweries Limited shares are owned by A at the time of his death, then the gift of Shs 100,000 will not fail due to ademption (see below), but will be paid as a general legacy. If A's shares in Kenya Breweries Limited realize only Shs

40,000, then Shs 40,000 is deemed to be a specific legacy and Shs 60,000 (the remaining part of the gift) is deemed to be a general legacy.

In a U.K case (Mullins v. Smith), it was held that a legacy described as "Kshs.100 Consols out of my Kshs.500 Consols", or "Kshs.100, part of my Kshs.500 Consols", is a specific legacy. In another case (Re. Boyd, Boyd v. Boyd) it was held that the will may show an intention to bequeath the identical asset; certain pecuniary legacies amounting to Kshs.710 were directed by the will to be paid "with and out of the proceeds" of the sale of the testator's investments comprising stocks and shares; these realized only Kshs.487; it was held that, as the fund specified for payment of the legacies was insufficient, they must abate rateably inter se (amongst themselves) and they were not payable out of the general estate. Whereas a legacy of "Kshs.100 payable out of my Kshs.500 Consols" is a demonstrative legacy (Kirby v. Potter).

(d) A gift of residue

Where property is not given by a specific legacy nor by a general legacy, it makes up the residue of the testator's estate. If the testator fails to make a gift of his residue, he dies partially intestate. The rules of intestacy will apply to the property comprising his residue. If a gift of property fails due to lapse or uncertainty, the property falls into the residue.

A "general residuary bequest" is defined as a testamentary gift of all property of the testator not otherwise disposed of.

(e) Types of interest given under a will

The interest given in a legacy, devise or gift of residue may be of the following kinds:-

1. **Vested** A vested interest gives an immediate indefeasible title although possession might be deferred. An illustration is the interest of a remainderman while the life tenant is still alive.
2. **Contingent**
A contingent interest is dependent on the happening of some specific event. An example is the interest of the second life tenant of a trust while the first is still alive.
3. **Absolute**
An absolute interest gives full power over property including the power to dispose.
4. **Limited**
A limited interest gives only the power of enjoyment for a limited period of time.
5. **Conditional**
A conditional interest is dependent on the beneficiary fulfilling some condition before his title is made absolute.

(f) Cumulative and substitutional legacies and devises

Where a will makes two gifts of unequal amounts to the same person, they are assumed, in the absence of a contrary indication, to be cumulative.

Where a will makes two gifts of equal amount to the same person, the presumption is that the second was in substitution for the first, unless evidence to the contrary is shown.

If two clauses of a will are irreconcilable, so that they cannot stand together, the last shall prevail. Obvious clerical errors can be corrected.

7.4 CAUSES OF FAILURE OF LEGACIES AND GIFTS OF RESIDUE

a. Ademption

If property which has been specifically bequeathed does not belong to the testator at the time of his death, or has been converted into property of a different kind, the gift cannot take effect by reason of the subject of the gift having been withdrawn from the operation of the will; where a gift fails on this

account, it is said to be "adeemed". There must be a substantial change in the subject of a specific legacy to cause ademption and a merely nominal change shall not have that effect.

The gift of an interest in a fund shall not be adeemed by any sale or change of investment of the fund by the persons having control thereof, nor shall it be adeemed by the testator receiving it before his death, whether or not thereafter sold or re—invested by him, if it can at his death be followed and distinguished.

A demonstrative legacy is not adeemed if the property on which it is charged by the will does not exist at the time of the death of the testator, or has been converted into the property of a different kind; in these cases, it is paid out of the general estate of the testator.

Where a testator makes a gift by will to any person for a specific purpose, or to any child or other person to whom he stands in loco parentis (i.e. in the place of that person's parent) by way of portion ("portion" means provision by a parent or person in loco parentis to establish a child in life) and after the date of execution of the will, provides by deed or settlement or otherwise for the same purpose or by way of portion for the same child or other person, there shall be a presumption that the gift is adeemed by the subsequent provision, so far as the subsequent provision extends.

b. Uncertainty

A gift or disposition not expressive of any definite intention shall be void for uncertainty, i.e. A gift under a will fails where there is uncertainty as to:

- i. What is being given
- ii. To whom it is being given, or
- iii. The quantity of the interest being given

E.g. A leaves **some of his property** to B; or A leaves his house in Karen to **some of his children**. However, no gift for charitable purposes is void because of uncertainty of the object. Also, no gift whereby the legatee is expressly or impliedly given a right of selection, purchase or disposition is void merely by reason of the uncertainty arising from that right. Where property is bequeathed to any person, the gift shall be presumed to comprise the whole interest of the testator in that property, unless it appears from a will that only a restricted interest was intended for him. The object of a gift which refers to a person or persons as existing, shall be construed as at the date of the will, unless a contrary intention clearly appears therein.

c. Disclaimer

A beneficiary can always disclaim a legacy and probably would do so if the gift involves onerous conditions. He may also do so when he wishes to increase the share of residue passing to some other beneficiary.

d. Lapse

If the legatee pre-deceases the testator, the gift fails; it is said to "lapse".

E.g. In his will, A leaves B Shs 100,000. B dies before A; A then dies. Since it is useless to pass money to a dead person, the gift fails due to "lapse"; the gift is said to "lapse".

The subject of the gift, in this case Shs 100,000, passes into the residue.

Exceptions to the rule of lapse:

There is no lapse in either of the following cases:

1. Where the gift or disposition is made in discharge of a moral obligation recognised by the testator; or
2. Where the gift or disposition is in favour of any child or other issue of the testator, for any estate or interest not determinable at or before the death of the child or other issue and the child or other issue leaves issue surviving the testator.

In either case, the gift or disposition takes effect as if the deceased legatee had died immediately after the testator.

E.g. In his will, K left his house to his eldest son M. M pre-deceases his father, but leaves his children P and Q who are alive at the time of his father's (i.e. X's death). In his will, M leaves all of his estate to his wife Mrs. M. The fact that P and Q are alive at K's death keep in place the gift to M; the house passes to M's estate, and by means of M's will, passes to Mrs. M (Carefully **contrast** this position with the **per stirpes** rule in intestacy).

e. Gifts subject to an illegal condition

A gift will fail if it has an illegal condition attached to it.

E.g. I give Shs.100,000 to Mwangi provided he murders his house-keeper.

f. Gifts subject to a condition which is contrary to public policy.

Where a gift is subject to a condition which is contrary to public policy, the gift will **not** fail but the beneficiary will take without the condition.

E.g. I give Shs.1m. to my wife on the condition that she shall not marry again.
The wife will take the legacy but remain free to marry again.

g. Abatement: In case the legacy is not adequate to meet all the dues of the beneficiaries, the dues will be reduced in proportion to what is available from the legacy.

7.5 ABATEMENT OF LEGACIES

- (a) If the assets, after the payment of debts, necessary expenses and specific legacies, are not sufficient to pay all the general legacies in full, the latter abate in equal proportion, and the personal representative has no right to pay one legatee in preference to another nor to retain any money on account of a legacy to himself or to any other person for whom he is a trustee; however, if the personal representative is entitled to a priority in respect of his remuneration, that priority is upheld.
- (b) For the purposes of abatement, a legacy for life, a sum appropriated by the will to produce an annuity, and the value of annuity when no sum has been appropriated to produce it, shall be treated as general legacies.
- (c) Where there is a specific legacy and the assets are sufficient for the payment of debts and necessary expenses, the thing specified must be delivered to the legatee without any abatement.
- (d) Where there is a demonstrative legacy, and the assets are sufficient for the payment of debts and necessary expenses, the legatee shall have a preferential claim for payment of his legacy out of the fund from which the legacy is directed to be paid until the fund is exhausted, and if the fund is exhausted, but part of the legacy still remains unpaid, he shall be entitled to rank for the remainder against the general assets as for a legacy of the amount of the unpaid remainder.

- (e) If the assets are not sufficient to answer the debts and the specific legacies, an abatement shall be made from the latter rateably in proportion to their respective amounts.
- (f) Where personal representatives have given such notice as may be prescribed for creditors and others to send in their claims against the estate of the deceased, the personal representatives can distribute the assets of the estate at the expiration of the time stated; they shall not be liable for the assets so distributed to any person of whose claim they have not had notice at the time of distribution. The creditor or claimant has the right to follow the asset in the hands or persons who received them.
- (g) Where personal representatives have paid any legacy which, but for the payment, would have been liable to abatement as above, they shall be entitled to call upon the legatee to refund the amount by which the legacy should have abated only if:
 - i. The legacy was paid under any order of the court; or
 - ii. If and so far as the abatement is rendered necessary by discovery of a debt of which the personal representative had no notice at the time of voluntary payment of the legacy.

7.6 PRESUMPTION OF SURVIVORSHIP

Where two or more persons have died in circumstances rendering it uncertain which of them survived the other or others, the deaths shall, for **all** purposes of the Succession Act, be presumed to have occurred in order or seniority, and accordingly the younger shall be deemed to have survived the older; however, in the case of spouses who die in these circumstances, the spouses shall be presumed to have died simultaneously.

7.7 INVESTMENT OF FUNDS TO PROVIDE FOR LEGACIES AND INTEREST ON LEGACIES

- (a) Where a general legacy is given for life, the sum bequeathed shall, at or before the end of a year after the death of the testator, be invested in any authorised investment; however, when an annuity is given and no fund is charged by the will with its payment, or appropriated by the will to answer it, a sum sufficient to produce the annuity shall be invested in any authorised investment.
- (b) Where a general legacy is given to be paid, at a future time, the personal representative shall invest a sum sufficient to meet it in any authorised investment. The intermediate interest from the investment shall, unless expressly or by implication be payable to the legatee or another, form part of the residue of the testator's estate.
- (c) Where a gift is contingent, the personal representatives shall not be bound to invest the amount of the legacy, but may transfer the whole residue of the estate to the residuary legatee, if any, on his giving sufficient security for the payment of the legacy if and when it becomes due.
- (d) Where a testator has given any property to a person for life without any direction to invest it in any particular securities, so much thereof as is not at the time of the testator's death invested in an authorised investment, shall be converted into money and invested in such an investment. Until conversion and investment are completed as above, the person, who would for the time being be entitled to the income of the fund when so invested, shall receive interest at 6% per annum upon the market value at the testator's death of such part of the fund as has not been so converted and invested.
- (e) A contingent of future, as well as an immediate specific legacy and a residuary bequest not contingent in its terms of property, whether immovable or movable, shall carry the intermediate income of that property from the death of the testator, except so far as the income, or any part thereof, may be otherwise expressly disposed of.

- (f) Where no time has been fixed for the payment of a general legacy, interest shall begin to run from the expiration of one year from the testator's death; where a time has been fixed for payment, interest shall begin to run from the time fixed. In either case, the interest up to that period shall form part of the residue of the testator's estate. However, interest shall run from the death of the testator where:
- i. The legacy is bequeathed in satisfaction of a debt; or
 - ii. The testator was a parent or more remote ancestor of the legatee or has put himself in the place of the parent of the legatee, and the legatee is a minor, and no specific sum is given by the will for maintenance; or
 - iii. The legacy is bequeathed to a minor with a direction to pay for his maintenance thereout.
- (g) No interest shall be payable on the arrears of an annuity within the first—year from the death of the testator although a period earlier than the expiration of that year may have been fixed by the will for making first payment of the annuity.
- (h) Where a sum of money is directed to be invested to produce an annuity, interest shall be payable on that sum from the death of the testator until so invested.

The rate of interest payable under paragraphs (e) to (f) inclusive shall be 6% per annum, unless otherwise expressly stated.

Paragraphs (e) to (h) inclusive apply in so far as a contrary intention does not appear from the will.

7.8 PROTECTION OF PROPERTY OF A DECEASED PERSON

- (a) No person may take possession of or dispose of or otherwise intermeddle with, any free property of a deceased person, unless he is expressly authorised by the Succession Act or by some other Act.
- (b) If a person contravenes the above he is guilty of an offence and is answerable to the rightful executor or administrator to the extent of the assets with which he has intermeddled after deducting any payments made in the due course of the administration.
- (c) Whenever it becomes known to any police or administrative office that any person has died, he shall forthwith report the fact of his death to the administrative officer of the area (unless he knows that this has already been done).
- (d) If the administrative officer is requested by any person who appears to have a legitimate interest in the estate or if no application for representation in respect of the estate has been made within one month of the date of death of the deceased, the officer will proceed to the last known place of residence of the deceased and take all necessary steps for the protection of his free property found there, for ascertainment of his other free properties (if any), for ascertainment of all persons appearing to have any legitimate interest in succession to or administration of his estate and for the guidance of prospective executors or administrators as to formalities and duties.
- (e) The High Court has jurisdiction to deal with any application and determine any dispute under the Succession Act.

7.9 APPLICATION FOR GRANT

- (a) An application for a grant of representation ("representation" means the probate of a will or the grant of letters of administration) is made in such a form as is prescribed, signed by the applicant and witnessed in the prescribed manner. Probate is the certificate of a court of competent jurisdiction that a will, of which a certified copy is attached in the case of a written will, has been proved a valid will with a grant of representation to the executor in respect of the estate.

The application must include information as to:

1. The full name of the deceased;
2. The death and place of his death;
3. Whether or not the deceased left any will;
4. The relationship (if any) of the applicant to the deceased;
5. Whether or not the deceased left any will;
6. The present addresses of any executors appointed by any such will;
7. In cases of total or partial intestacy the names and addresses of all surviving sponsors, children, parents, brothers and sisters of the deceased, and of the children of any child of his or hers then deceased.
8. A full inventory of all the assets and liabilities of the deceased; and,
9. Such other matters as may be prescribed.

(b) If in the application it is claimed that the deceased left a valid will, then

1. If it was written the original will must be annexed to the application, or it is alleged to have been lost or destroyed otherwise than by revocation, or if for any other reason the original cannot be produced, then either
 - i. An authenticated copy thereof shall be annexed; or
 - ii. The names and addresses of all persons alleged to be able to prove its contents shall be stated in its application.
2. If it was oral, the names and addresses of all alleged witnesses shall be stated in the application.

(c) No permission of any information from an application shall affect the power of the court to entertain the application.

(d) Any person who makes an application and willfully or recklessly makes a statement in it which is false is guilty of an offence punishable by a fine of Shs.10,000 or to up to a year, or both.

(e) A court may:

1. Wherein a deceased person is proved whether by production of a will or authenticated copy of the will or by oral evidence of its content, to have left a will, grant, in respect of all property to which the will applies either:
 - i. Probate of the will ("Probate" means the certificate of a court of competent jurisdiction that a will of which a certified copy is attached in the case of a written will, has been proved a valid will with a grant of representation to the executor in respect of the state) to one of more of the executors name therein; or
 - ii. Where there is no providing executor, letters of administration, with the will annexed; and
2. If and so far as there may be intestacy letters of administration in respect of the intestate estate.

(f) A court may limit a grant of representation which it has jurisdiction to make, as follows:

1. Where the will has been lost or mislaid since the testator's death or has been destroyed by wrong or accident and not by any act of the testator and a copy of the draft of the will has

- been preserved, probate may be granted of the copy or draft limited until the original or a properly authenticated copy of it is produced;
2. When a will is in the possession of a person residing outside Kenya who has refused or neglected to deliver it, but a copy has been transmitted to the executor, and it is necessary for the interest of the estate that probate should be granted without waiting for the arrival of the original, probate may be granted of the copy so transmitted; limited until the will or an authenticated copy of it is produced;
 3. Where no will of a deceased is forthcoming, but there is reason to believe that there is a will in existence, letters of administration may be granted, limited until the will or an authenticated copy of it is produced;
 4. When any executor is absent from Kenya and there is no executor in Kenya willing to work, letters of administration with the will annexed may be granted to the attorney of the absent executor for the use and benefit of his principal, limited until he shall obtain probate or letters of administration granted to himself;
 5. When a minor is sole executor or sole residuary legatee, letters of administration with the will annexed may be granted to the legal guardian of the minor or to such other person as the court think fit until the minor has attained full age at, which time, and not before, probate of the will is granted to him; in the case of several minors, when the others reach full age;
 6. When a sole executor is a person of unsound mind, letters of administration with the will annexed is granted to the person to whom the care of the executor's estate has been committed by a competent authority, or if there is no such a person, to such other person as the court thinks fit, until the executor becomes a sound mind;
 7. Where there is a suit touching the validity of the will or obtaining or revoking any probate or any grant or letters of administration, the court may appoint an administration of the estate of the deceased person who shall have all the rights and powers of a general administration other than the right of distributing the estate; the administrator is subject to the immediate control of the court act under its direction;
 8. If an executor is appointed for a limited purpose specified in the will, the probate shall be limited to that purpose;
 9. If an executor appointed generally gives an authority to an attorney to prove a will on his behalf and the authority is limited to a limited purpose, the letters of administration, with the will annexed shall be granted subject to the exception;
 10. Whenever a grant, with exception, of probate or letters of administration with or without the will attached has been made, the person entitled to probate or administrator of the remainder of the deceased's estate may take a grant of probate or letters of administration of the rest of the deceased's estate;
 11. If the executor to whom probate has been granted dies leaving part of the testator's estate unadministered, a new representation may be appointed for the purpose of administering that part of the estate;
 12. When a limited grant has expired by effluxion of time, or the happening of the event or contingency on whom it was limited, and there is still some part of the deceased's estate unadministered, letters of administration shall be granted to those persons to whom the original grant might have been made.
- (g) No grant of representation shall be made to;
- i. A person who is a minor, or of unsound mind, or a bankrupt; or
 - ii. To more than four persons in respect of the same property.
- (h) No grant of letters of administration, with or without the will annexed, shall be made to a body corporate other than the public trustee or a trust corporation.

- (i) No grant of representation shall be made to a syndicate or nominee on behalf of a body corporate.
- (j) A person who has been appointed by a will, as an executor thereof, may either by oral declaration before the court or by writing under his hand denounce executorship and shall there after be precluded from applying for grant of probate of that will.
- (k) Where several executors are appointed, probate may be granted to them all simultaneously or at different times.
- (l) Where a deceased has made a will; but:
 - 1. He has not appointed an executor; or
 - 2. The only executors appointed are legally incapable of acting, or have died before the testator; or before receiving a grant of probate of the will, or have failed within the time limited by a citation to apply a probate thereof; or
 - 3. All proving executors have died before completing administration of all the property to which the will applies,
A universal or residuary legatee may be admitted to prove the will and letters of administration with the will annexed may be granted to him of the whole estate or of so much as may be unadministered.
- (m) When a deceased has died intestate, the court has a final discretion as to the person or persons to whom a grant of letters of administration is made, in the best interest of all concerned.

As a general guide, the following order of preference is given.

- i. The surviving spouse with or without association of other beneficiaries;
- ii. Other beneficiaries entitled on intestacy with priority as per the priority to property on an intestacy;
- iii. The public trustee;
- iv. Creditors.

When there is partial intestacy, letters of administration in respect of the intestate estate shall be granted to any executor(s) who prove the will.

7.10 POWERS AND DUTIES OF PERSONAL REPRESENTATIVES

(a) Personal representation shall have the following powers:

- 1. To enforce for the deceased's estate by suit or otherwise all causes of action that survive the deceased or arise out of his death;
- 2. To sell all or any of the assets valued in them as they think best; however
 - a. The purchase by them of any such assets shall be voidable at the instance of any other person interested in the assets to purchase.
 - b. No immovable property shall be sold before confirmation of the grant.
- 3. To assent, at any time after the confirmation of the grant, to the vesting of a specific legacy in the legatee thereof:

4. To appropriate, at any time after confirmation of the grant, any of the assets valid in them in the actual condition or state of investment thereof at the time of appropriation in or towards satisfaction of any legacy bequeathed by the deceased or any other interest or share in estate, whether or not the subject of a continuity trust, as may seem just and reasonable to them according to the respective right to the persons interested in the estate of the deceased and for that purpose to ascertain and fix (with the assistance of a duly qualified valuer, where necessary) the value of the respective assets and liabilities of the estate, and to make any transfer that may be required to give effect to the appropriation.

However,

- a. No appropriation shall be made so as to effect adversely any specific legacy (unless expressly provided in the will);
- b. No appropriation shall be made for the benefit of a person absolutely and beneficially entitled in possession, without his consent, nor for the purpose of a continuity trust without the consent of either the trustees thereof or the person for the time being entitled to the income thereof;

(b) Personal representation have the following duties;

1. To provide and pay out of the estate of the deceased, the expenses of a reasonable funeral for him;
2. To get in all free property of the deceased, including debt owing to him and money payable to his personal representatives by reason of his death,
3. To pay out of the estate of the deceased all expenses of obtaining their grant of representation and all other reasonable expenses of representation administration (including estate duty if any);
4. To ascertain any pay out of the estate of the deceased all his debts;
5. within six months of the date of the grant, to produce to the court, a full and accurate inventory of the assets and liabilities of the deceased and a full and accurate account of all dealings therewith upto to the date of the account;
6. to distribute, or to retain on trust (as the case may require) all assets remaining after the payment of expenses and debts as provided by above including the income therefrom, according to the respective beneficial interest therein or under the will or on intestacy as the case may be.
7. within six months of the grant, or such longer period as the court may allow, to complete the administration of the estates in respect of all matters other than continuing trust, and to produce to the court, a full and accurate account of the completed administration.

7.11 EXECUTORS' ACCOUNTS

(a) Stewardship

The main object or preparing Estate Accounts is to record the assets which have been entrusted to the "stewards" — the executors — and the manner in which they have been applied.

(b) Distinction between income and capital

Where the estate has both a life tenant and a remainderman, it is necessary to segregate so as to distinguish between the interest of the life tenant in the income and that of the remainderman in the capital. Segregation is achieved either by the use of columns separating income from capital or separate accounts.

Where there is no life interest, this apportionment is not necessary.

(c) Apportionment

Apportionment may be according to statutory rules or those established in equity.

With the majority of items, it is relatively easy to decide whether they are capital or income, but in a few cases it is not possible to allocate them completely to either section.

In these cases it is necessary to **apportion** the item between income and capital.

The Apportionment Act sets out a number of situations in which an apportionment is to be made and such division between income and capital is termed a **statutory apportionment**. There are also a number of situations where the statutory apportionments do not apply.

In these cases, the courts have laid down rules as to how the division is to be made and these are termed **equitable apportionments**.

(d) **Accounts required**

The basic accounts required for an estate or trust are as follows:—

- i. Estate capital account;
- ii. Estate income account;
- iii. Estate cashbook;
- iv. Various accounts for the assets and liabilities, income and expenditure of the estate or trust.

(e) **Executors' accounts and trustees' accounts**

Executors' and trustees' accounts are in many respects similar. Both distinguish between income and capital but may do so for different reasons.

Estate accounts arise because of the death of a person.

Trustees' accounts may arise simply as an extension of estate accounts, where part of the deceased's property is held in trust. Alternatively, trust accounts may arise as a result of a settlement inter vivos.

Note particularly the following differences between estates and trusts:—

1. **Estate:** on the death of a testator or an intestate, all assets, including income accrued up to the date of death, are capital: income arising after death is income.
2. **Trust:**
 - i. On the death of a life tenant under a settlement, if followed by a remainderman, all income up to the date of death belongs to the life tenant's estate: income arising after the death of the life tenant, together with the assets of the trust, is due to the remainderman;
 - ii. On the death of a life tenant under a settlement who is succeeded by a further life tenant, income accrued up to the death of the former life tenant is due to his estate: income accruing after his death is due to the succeeding life tenant.

(f) **The opening entries**

1. **Assets of the estate or trust**

In both cases the various assets of the estate or trust are debited to appropriate accounts and credited to the **Estate Capital Account**;

The value at which assets are introduced is as follows:—

- a) In the case of an estate or a trust following an estate — **probate value**;
- b) In the case of an **inter vivos** settlement — **market value** at the date of the settlement.

2. **Liabilities of the estate or trust**

The various liabilities of the estate or trust are credited to appropriate accounts and debited to the **Estate Capital Account**.

3. **Balance on Estate Capital Account**

The balance on the capital account of an estate will represent the net value of the deceased's estate.

When Estate Duty used to be charged in Kenya, the balance on the estate capital account was the figure on which Estate Duty was charged, subject to adjustments (in exactly the same way as Income Tax is charged on the net profit of a business, subject to adjustments).

7.12 APPORTIONMENT

(a) **The purpose of the apportionment rules**

The purpose of the various rules of apportionment is to provide a fair and reasonable basis for dividing certain items between the conflicting interests of the life tenant and the remainderman.

The rules may be considered under the following three headings;

- i. Statutory apportionments;
- ii. Variation of securities;
- iii. Equitable apportionments.

(b) **Statutory apportionments**

Where income has been received in respect of a period which "bridges" the date of a death, it must be apportioned between the two parts of the period on a **time basis**. This applies to all rents, annuities, dividends and similar items.

The following possibilities can be distinguished in the estate of a deceased person:—

1. **Investment with cum.div. quotation** will be debited to the investment account at its full value. When the dividend is subsequently received it is apportioned:

- i. Amount accrued to death being credited to capital column of the investment account
- ii. Amount accrued after death being credited to the income column.

The amount apportioned to capital should be transferred out of the Investment Account (thus maintaining the investment at its probate value) and credited to Estate Capital Account.

Example	Date of death:	30th June, 20X5
	Stock:	6% Treasury Stock
	Interest paid:	1st March 30th September
	Holding:	Shs 2m quoted at 94-96

Investment Account

20X5		Nominal Sh'000	Income Sh'000	Capital Sh'000	20X5		Nominal Sh'000	Income Sh'000	Capital Sh'000
June 30	Estate Capital Account (stock at death)	2,000		1,890	Sept 30	Estate Cash Book (interest pre-death)			30
Sept 30	Estate Capital Account			30		post-death		30	

2. **Investment with ex. div. quotation** will be debited to the investment account at its **ex. div.** value. The full impending dividend will also be debited to the Investment Account. When the dividend is subsequently received it is apportioned in the same way as a) above. A journal transfer is then made from the Capital column of the Investment Account to the debit of the Estates Capital Account in order to restore the book value of the investment to its probate (quarter—up) value.

Example	Date of Death:	30th June, 20X5
	Stock:	3% Kenya Stock
	Interest paid:	31st January 31st July
	Holding:	Shs 6m quoted at 86—88 ex.div.

20X5		Nominal Sh'000	Income Sh'000	Capital Sh'000	20X5		Nominal Sh'000	Income Sh'000	Capital Sh'000
June 30	Estate Capital Account (stock at death)	6,000		5,190	July 31	Estate Cash Book (interest pre-death post-death)			75
	(interest due)			90	July 31	Estate Capital Account		15	15

3. **An interim dividend** may have been received by the deceased before death. This cannot be apportioned and belongs exclusively to capital. The interim dividend must be brought into account when apportioning any final dividend between income and capital.

Example	Date of death:	30th June, 20X5
	Stock:	BAT(K) Ltd. ordinary shares
	Holding:	2,000 ordinary shares of Sh10 each quoted at Sh129 — Shs133
	Dividends received:	Interim of 25% for year to 30th September 20X5, received on 31st May 20X5. Final of 100% for year to 30th September 20X5, received on 30th November, 20X5

		Shs	Income Shs	Capital Shs
20X5				
Nov.30	100% Final Dividend for year to 30th Sept. 20X5	2,000		
Add: —	25% Interim dividend received before death.	5,00		
	Pre—death (9 months)			18,750
	Post—death (3 months)		6,250	
Deduct: -	Interim dividend		<u> </u>	<u>5,000</u>
			<u>6,250</u>	<u>13,750</u>

BAT (K) Ltd
as above **BUT**
Interim Dividend of 11%
Final Dividend of 15%

		Shs	Income Shs	Capital Shs
20X5				
Nov.30	15% Final Dividend for year to 30th Sept.20X5	3,000		
Add: —	110% Interim dividend received before death	<u>22,000</u>		
		<u>25,000</u>		
	Pre-death (9 months)			18,750
	Post-death (3 months)		<u>6,250</u>	

As interim dividend exceeds amount apportionable to capital, the whole final dividend of Shs3,000 goes to **income**.

3. **Arrears of preference dividend** are apportioned according to the period of the Income statement out of which they are paid (not the period to which they relate). (Re.Wakley)

E.g.	Date of death:	30th June, 20X5
	Stock:	Kenya Power and Lighting Co. Ltd.
		6% cumulative preference shares of Shs 20 each
	Holding:	10,000 shares quoted at Shs7.95 — Shs8.15

Dividend received: 30th November 20X5. 24% dividend being 4 years arrears of cumulative preference dividend paid out of the profits for the year to 30th September 20X5

		Income Shs	Capital Shs
20X5 30th Nov.	26% dividend paid out of profits for year to 30th Sept. 20X5		
	Pre-death (9 months)		<u>39,000</u>
	Post-death (3 months)	<u>13,000</u>	

5. **Dividends out of the capital profits** are apportioned on the same basis as dividends out of income (Re. Doughty).

(a) **Variation of securities**

It would seem logical to carry out a strict apportionment between income and capital every time investments are bought or sold. If this were done, it would be necessary to divide the purchase price or sale proceeds between the pure capital element and the adjustment of income rights.

In practice, **this is not done**, following the rules of convenience, on the grounds that it unnecessarily complicates the accounts. The situation is, therefore, as follows:

1. **Purchase of investment cum. div.** The life tenant is entitled to the whole income when received, **except** where the **investment is purchased cum. div.** after the dividend has been declared, when the whole dividend goes to capital (Re. Peel's Settled Estates).
2. **Disposal of investment cum. div.** The life tenant is not entitled to any of the sale proceeds (**Scholefield v. Redfern**).
3. **Disposal of investment ex. div.** The whole dividend received after disposal belongs to the life tenant.

Any organized course of action to the detriment of the life tenant or the remainderman would be actionable by that party as a breach of trust.

(b) **Equitable apportionments**

There are five leading cases where the courts have laid down rules to meet specific situations in which there is a conflict of interest between life tenant and remainderman.

Equitable apportionments may be (and frequently are) barred by the will.

The five leading cases are as follows:—

- i. **Howe v. Earl of Darmough** — where an estate contains unauthorized investments of a hazardous or wasting nature;
- ii. **Re. Earl of Chesterfield's Trusts** — where an estate contains non—income producing assets;
- iii. **Allhusen v. Whittell** — concerning the payment of expenses out of the estate;
- iv. **Re. Perkins** — concerning the payment of annuities out of the estate;
- v. **Re. Atkinson** — where one of the assets of the estate is a mortgage for which there is insufficient security and a loss eventually accrues to the trust.

It is not necessary to know these rules in detail.

Example

With reference to the provisions of the law of succession:

Define a will;

(2 marks)

Give two short explanation of failure of legacies.

(4 marks)

Mr Ruare dies intestate, leaving his two wives Luky and Chity whom he married under a system of law which permits polygamy. A third wife Beaty had predeceased him. Luky has three children Peter, Lowe and Ricci. Beaty had two children Short and Tall. Chity has no children.

All the children are alive at the time of Mr. Ruare's death. The value of his personal and household effects was Sh.350,000 and the value of the net intestate estate was Sh.3,150,000.

Required:

A clear statement to show how Mr. Ruare's property would devolve. (15 marks)

Solution

- (a) (i) A will is a legal declaration by a person of his wishes and intentions regarding the disposition of his property after his death duly made and executed according to the provisions of the law of Succession Act.
- (ii) Reasons for failure of legacies:

Ademption

When the gift specifically bequeathed does not exist within the testator's property at the time of death, the gift is said to have "adeemed". However, if the gift had been converted into property of a different kind, and such new property falls into the category "traceable" such new property will replace the original gift and be handed over to the beneficiary.

Lapse

Where the beneficiary (legatee) predeceases the testator (legator) the gift is said to fail due to "lapse". There are two exceptions to the rule:

If the legatee is an issue of the testator; and the legatee, although deceased, left surviving issue of their own, the gift will pass to such surviving issue from the testator's estate).

The testator felt a moral need (or recognised a moral obligation) towards the legatee.

Uncertainty

A gift not expressive of any definite intention shall be void for uncertainty; such uncertainty arising as to:

What is being given

To whom it is being given

The quantity of the interest being given.

Disclaimer

A beneficiary can always disclaim a legacy – and will probably do so if the gift is subject to unfair or unreasonable conditions.

Gifts subject to illegal conditions

A gift will fail if it has an illegal condition attached to it, eg " I leave Sh.20,000 to my gardener Mwangi provided he murders my wife". However if the gift is only subject to a condition contrary to public policy (repugnant to equity and justice) the gift will pass whether the condition was fulfilled or not.

- (b) Mr Ruare:

The law of intestacy provides for the following situations:

A deceased intestate does not leave behind a spouse or children.

A deceased intestate is survived by a spouse but no children

A deceased intestate is survived by children but no spouse.

A deceased intestate leaves behind both a spouse and children.

NB: If a deceased intestate leaves behind several wives and children all wives married under a system of law that permits polygamy, then his property is divided according to the “households”, after which any of the 4 situations above may apply.

The division amongst the “households” is based on the number of units in each household – where “Unit” refers to surviving spouse or child.

In the case of Mr Ruare:

Households:	House A	House B	House C	Total
Spouse:	1 unit	1 unit	-	2 units
Children	3 units	-	2 units	<u>5 units</u>
				<u>7 units</u>
Property division				
Fractions	4/7	1/7	2/7	

Distribution of personal and household effects:

House A: Luky will obtain absolutely:

$$4/7 \times 350,000 = \text{Sh. } 200,000 \text{ of household effects.}$$

House B: Chity will obtain absolutely:

$$1/7 \times 350,000 = \text{Sh. } 50,000 \text{ of household effects.}$$

House C: Short and Tall will each get absolutely

$$1/2 \times 2/7 \times 350,000 = \text{Sh. } 50,000 \text{ each in household effects.}$$

(This is because their mother Beaty had already died).

Distribution of intestate’s net estate

House A: Luky will get a life interest in the net estate worth.

$$4/7 \times 3,150,000 = \text{Sh. } 1,800,000$$

Upon her death (or remarriage) it will be divided equally amongst Peter, Lowe and Ricci – each getting Sh. 600,000 worth of property.

Household B:

Chity will get a life interest in property worth

$$1/7 \times 3,150,000 = \text{Sh. } 450,000.$$

Upon her death, (or remarriage) it will devolve as follows:

To Mr Ruare’s father; or if dead

To Mr Ruare’s mother; or if dead

To Mr Ruare’s brothers and sisters and children of deceased brothers and sisters in equal shares; or if none.

To Mr Ruare’s half brothers and half sisters and children of deceased half brothers and half sisters in equal shares; or if none.

To relatives who are in the nearest degree of consanguinity up to and including the sixth; or if none
To the consolidated fund of the government.

Household C:

Beaty's children short and Tall will each obtain property worth:

$\frac{1}{2} \times 2/7 \times 3,150,000$ absolutely.

This amounts to Sh. 450,000 per person.

	Luky	Chity	Peter	Lowe	Ricci	Short	Tall
Household & Personal	200,000 (absolute)	50,000 (absolute)	-	-	-	50,000 (absolute)	50,000 (absolute)
Net estate	1,800,000 (Life Interest)	450,000 (Life interest)	600,000 (Absolute upon death or remarriage of luky)	600,000	600,000	450,000 (Absolute)	450,000 (Absolute)

Example

Mali Mengi (aged 57) died in a road accident on 31 December 1999. On 1 May 2000 after his executors had paid all debts (except for the mortgage for his freehold house and debt to Mkopeshaji) testamentary and funeral expenses, his estate was ascertained as follows:

	Sh. '000'
Cash in bank accounts	4,250
Freehold house	3,250
Toyota corolla	360
Nissan sunny	220
Television and music system	105
Debt due from Pungufu	40
Furniture and personal effects	302
10,000 ordinary shares in Cement Ltd.	1,200
4,500 ordinary shares in Soko Mjinga Ltd.	370
Sh.800,000 10% Kenya stock	165
Income received to date	
Interest	230
Dividend from Soko Mjinga Limited	<u>37</u>
	<u>267</u>
Less: Mortgage interest paid 31 march 2000	<u>120</u>
	<u>147</u>
	<u>10,409</u>

Extracts from Mali Mengi's will left bequests as follows:

- To each of my sons. Kikwajuni, Mnazini, and Mwembeni Sh.1 million.

2. To my wife Darajani, I leave my furniture, household and personal effects and the residue of my estate.
3. To my daughter Nanjale, my freehold house free of all duties. The house was subject to a mortgage of Sh.1 million carrying interest at 24% per annum payable 31 March and 30 September. Duty on the house amounts to Sh.130,000.
4. To my friend Kisitu, one of the motor cars owned by me at the time of my death he may choose.
5. To my friend Mlungu Sh.100,000.
6. To my sisters-in-law Sh.300,000
7. To my cousin, Nipa, my painting of Mausoleum by Kikuvu.
8. To my driver Ndeleva Sh.150,000
9. To my friend Shimba, my holding of Sh.800,000 110% Kenya stock, Mali Mengi owed Shimba Sh.100,000.
10. To my sister Malindi Sh.300,000
11. To my personal assistant, Sijapata half of my holdings in Cement Ltd.
12. To my niece Sinani, 4,000 ordinary shares from my holding of such shares in Cement Ltd.
13. To my nephew Shaibu Sh.200,000 payable out of my shares in Cement Ltd.
14. To my friend Mlungu Sh.50,000.
15. To my neighbour, Jirani Sh.50,000.
16. To my sister Dada, Sh.100,000 to establish a business.

Mali Mengi executors ascertained the following beneficiaries were dead:

- Son Mnazini died in 1997 leaving a wife and two children.
- Son Mwembeni died in 1998 leaving a wife.
- Sister Malindi died in 1996 leaving two daughters.
- Driver, Ndeleva aged 60 died in the same accident as Mali Mengi. It was impossible to determine the order in which Mali Mengi and Ndeleva died.

The executors also advise you that:

- (i). Kisitu chose the Toyota corolla
- (ii). Mali Mengi sold his painting of the mausoleum using the proceeds to purchase his holding in Soko Mjinga Ltd.
- (iii). There is no such investment as 110% Kenya stock. The referees in the will to 110% is thought to be a typing error not previously noticed.
- (iv). Jirani replied in writing that he did not want anything from Mali Mengi because Mali Mengi was a bad neighbour.
- (v). Mali Mengi paid the Sh.100,000 during his life to his sister Dada to establish a business.

Required:

- (a) A statement showing the distribution of Mali Mengi's estate on 1 May 2000. (16 marks)
- (b) A list of legacies to which the executors should not assent, briefly give reasons for the decision.

(4 marks)

(Total: 20 marks)

Solution

(a) RE: MALI MENGI

STATEMENT OF DISTRIBUTION AS AT 01.05.2000

	Sh.000	Sh.000
Assets		
Cash and bank a/c		4,250
Freehold house		3,250
Toyota Corolla		360
Nissan Sunny		220
TV and Music system		105
Debt due from Pungufu		40
Furniture and Personal effects		302
10,000 ordinary shares in Cement Ltd		12,000
4,500 ordinary shares in Soko Mjinga		370
Sh.800,000 10% Kenya Stock		165
Income received to date		147
Recoverable from Nyanjale (W1)		<u>60</u>
		10,469
LIABILITIES		
Mortgage and house	1,000	
Duty payable on house	130	
Mortgage interest due for April (20% x 1000 x 1/12)	<u>20</u>	<u>(1,150)</u>
		9,319
SPECIFIC LEGACIES		
Wife Darajani: Furniture, TV & Music system	407	
Daughter Nyanjale: Freehold house	3,250	
Friend Shimba – Sh.800,000 10% Kenya stock	165	
Personal Assistance Sijapata: 5,000 shares in Cement	600	
Niece Sinani: 4,000 ordinary shares in Cement	480	
Nephew Shaibu: Proceeds on sale of 1,000 shares in Cement	120	
Friend Kisitu: Toyota Corolla	<u>360</u>	<u>5,383</u>
		3,937
GENERAL LEGACIES		
Son Kikwajuni	1,000	
Son Mnazini	1,000	
Friend Mulungu (100 + 50)	150	
Nephew Shaibu: Balance (200 – 120)	<u>80</u>	
Wife Daranjani		<u>1,707</u>
W1: Interest paid from 1 st October 1999 to 31 st March 2000		
$24\% \times 1,000 \times 6/12$	=	120
Interest from 1 st October 1999 to 31 st December 1999	=	<u>60</u>
		60

- (b)
- The house is to be given to Nyanjale free of duties i.e mortgage interest and duty
 - Sh.1 million to Mwembeni will fail due to lapse.

- The legacy to “som of sisters in law” will fail due to uncertainty of recipient.
- The gift to cousin Nipa will fail due to ademption. It was not owned by the testator at the time of his death.
- The legacy to Neleva will fail due to lapse. It is assumed that Ndeleva predeceased the testator because he was older.
- The legacy to sister Malindi will fail due to lapse.
- The demonstrative legacy will pass in 2 stages:
 - (i) Sh.12,000 when the balance of shares in Cement Ltd are sold
 - (ii) Sh.8,000 as a general legacy
- The gift to Jirani will fail due to disclaimer
- The gift to Dada will fail due to ademption.

Example

7.13 PRO—FORMA ACCOUNTS

Estate of Maina deceased

Date of death	30th June 20X4
Terms of will	Shs 500,000 and chattels to wife, residue to two children for life with remainder over to grandchildren. Equitable apportionments barred.

(a) Estate Capital Account

The purpose of this account is to show the capital of the estate or trust at any time, based on the book value of the various assets. The account opens with the net value of the estate and shows any changes in this value caused by profits or losses on disposal. It also shows the manner in which the estate has been dealt with in respect of estate duty paid, legacies paid, residue distributed and property retained in trust.

PRO—FORMA ESTATE CAPITAL ACCOUNT

20X4	Shs'000	20X4	Shs'000
Jun.30		Jun.30	
Liabilities at death		Assets at death	
Debts and funeral expenses account	200	Freehold house account	3,000
Balance c.down	12,545	Sh2m 6% Treasury Stock @ 94—96 account	1,890
		Sh6m 3% Kenya Stock @ 86—88 xd. account	5,190
		Add Whole of impending interest	90
		Chattels account	200
		Cash at bank account	300
		Life policy account	2,000
		Income due from trust (of which deceased was life tenant) account	75
	<u>12,745</u>		<u>12,745</u>
20X4		20X4	
Jul.31		Jun.30	
3% Kenya Stock account	15	Balance b/down	12,545
		Sep.30	
		6% Treasury Stock account	30
Aug.31		Sep.30	
Estate cash account	5,225	Freehold house account (profit on disposal)	200
20X5		20X5	
Jun.30		Apr.30	
Legacies account (distribution to widow)	7,00	6% Treasury stock account (profit on sale)	3
Jun.30			
Balance c/f (residue held in trust)	6,838		
	<u>12,778</u>		<u>12,778</u>

(b) Estate Income Account

The purpose of this account is to show the income of the estate or trust. Income received is credited gross to the account. Tax suffered together with tax to be paid under assessment is debited to the

account. Expenses properly chargeable to income are also debited. If a person is entitled to an annuity out of the income of the trust, this is debited **gross** to the account. The balance on the account is the amount due to the life tenant(s) and is transferred to their personal accounts.

PRO—FORMA ESTATE INCOME ACCOUNT
for the year ended 30th June 20X5

	Shs'000		Shs'000
Bank charges and interest	4	Interest receivable (gross)	
Payments on account to life tenants	100	6% Treasury stock	111
Balance carried forward	<u>187</u>	3% Kenya Stock	180
	<u>291</u>		<u>291</u>

(c) **Estate Statement of financial position**

PRO—FORM STATEMENT OF FINANCIAL POSITION— 30th June 20X5

	Kshs.		Sh'000	Sh'000
Estate capital account	67,855	Investments		
		6% Treasury stock Sh1.4m nominal	1,323	
		3% Kenya Stock Sh6m nominal	5,190	
		Cash at bank (capital)	325	6,838
Estate income Account	<u>337</u>	Cash at bank (income)	91	
	<u>Kshs.68,192</u>	Accrued interest:		
		6% Treasury Stock	21	
		3% Kenya Stock	<u>75</u>	<u>187</u>
				<u>7,025</u>
		Estate Capital Account		6,838
		Estate Income Account		<u>187</u>
				<u>7,025</u>

(d) **Estate cashbook**

This records all payments and receipts. A strict division between income and capital is maintained by the use of separate columns.

PRO—FORMA ESTATE CASH BOOK

20X4		Income Sh'000	Capital Sh'000	20X4		Income Sh'000	Capital Sh'000
Jun.30	Estate Capital Account (opening balance)		3,00	Aug.31	Estate Capital Account (Estate duty)		5,225
Jul.31	3% Kenya Stock Acc. (interest (pre-death (post- death)	15	75	Sep.30	Debts and funeral expenses acc. (debts and funeral exp. paid)		200
Jul.31	Life Policy Account (proceeds of life policy)		2,000	Dec.31	Estate income account (bank charges and interest)	4	
Sep.30	6% Treasury Stock Account (interest (pre-death (post- death)	30	30	20X5			
Sep.30	Freehold house account (sale of house)		3,200	May 31	Estate income account Sh50,000 paid on account to each life tenant)	100	
20X5				Jun.30	Legacies account (cash legacy to widow)		500
Jan.31	3% Kenya Stock account (interest (all post- death)	90		Jun.30	Balances c.fwd	91	325
Mar.31	6% Treasury Stock acc. (interest (all post- death)	60					
Apr.30	6% Treasury Stock acc. (saleSh0.6m nominal @ 95-96)		570				
Apr.30	Income due from trustaccount (income due to deceased at death)		75				
		<u>195</u>	<u>6,250</u>			<u>195</u>	<u>6,250</u>

(e) Other estate accounts

PRO—FORMA INVESTMENT ACCOUNT
6% Treasury Stock Interest paid 31st March-30th September

		Nom— inal	Inc— ome	Capital	Nom— inal	Inc ome	Cap— ital
20X4		Shs '000	Shs '000	20X4	Shs '000	Shs '000	Shs '000
Jun.30	Estate Capital acc. (probate value of invest— ment	2,000	1,890	Sep.30	Estate Cash Acc. (interest) (pre— death (post— death)	30	30
Sep.30	Estate Capital Account		30				
20X5				20X5			
Apr.30	Estate Capital Acc. (profit on sale)		3	Mar.31	Estate Cash Acc. (interest) all post— death	60	
Jun.30	Estate income acc. (income for yr— gross	111		Apr.30	Estate cash acc. (sale of stock)	600	570
		<u>2,000</u>	<u>1,923</u>	Jun.30	Balance c.fwd	<u>1,400</u> <u>2,000</u>	<u>21</u> <u>111</u> <u>1,323</u> <u>1,923</u>

PRO—FORMA INVESTMENT ACCOUNT
3% Kenya Stock Interest paid 31st January-31st July

		Nom- inal	Inc- ome	Cap- ital			Nom- inal	Inc- ome	Cap- ital
		Shs	Shs	Shs			Shs	Shs	Shs
20X4		'000	'000	'000	20X4		'000	'000	'000
Jun.30	Estate Capital Account (probate value of invest- ment)	6,000		5,190	Jul.31	Estate Cash Account (interest) (pre- death) (post- death)		15	75
	Add: impending interest			90	Jul.31	Estate Capital Account			15
20X5					20X5				
Jun.30	Estate Income Account		180		Jan.31	Estate Cash Account (interest) all post- death)		90	
					Jun.30	Balance c.fwd	6,000	75	5,190
		<u>6,000</u>	<u>180</u>	<u>5,280</u>			<u>6,000</u>	<u>180</u>	<u>5,280</u>

PRO-FORMA DEBTS AND FUNERAL EXPENSES ACCOUNT

20X4	Shs'000	20X4	Shs'000
Sept.30		June 30	
Estate Cash Account (debts and funeral expenses paid)	<u>200</u>	Estate Capital Account (debts and funeral expenses due)	<u>200</u>

PRO-FORMA LEGACIES ACCOUNT

20X5		Shs'000	20X5		Shs'000
June 30	Estate		June 30	Estate	
	Cash			Capital	
	Account	500		Account	
June 30	Chattels			(distri-	
	Account	200		bution to	
				widow)	700
		<u>700</u>			<u>700</u>

Example**QUESTION FIVE**

Kombo died on 31 October 2000 and left his estate as follows:

	Sh
Household furniture	90,000
Cash in house	2,000
Cash at bank	250,000
10,000 ordinary shares of Sh.20 each in KFC Ltd. Valued at Sh.30 per share.	300,000
Investment at 5% on freehold property securities (interest thereon paid to 30 June 2000)	400,000
Share in business of Kombo & Co. valued at death	1,226,000
Sundry debtors	20,000
His liability amounted to	5,000
Funeral expenses	10,000

The following additional information is available:

1. A legacy of Sh.20,000 was bequeathed to his executor and was paid on 28 January 2001.
2. The residue of the estate was left in trust for his infant son.
3. The household furniture was sold on 15 December 2000 for Sh.96,000.
4. The shares were sold on the same date at Sh.29 ex div: a dividend being received on 25 January 2001 at 10% for the year ending 31 December 2000.
5. Interest on investment in freehold property securities was received on 31 December 2000, on which date the shares in the business of Kombo & Co. was received with interest at 5% per annum.
6. The liabilities and funeral expenses were discharged on 20 December 2000 on which date Sh.10,000 of the debts due were received. The balance being unpaid at the date of preparation of the accounts.

Required:

- (a) Journal entries to record the above transactions (5 marks)
- (b) The Estate cash book (4 marks)
- (c) The Estate income account (3 marks)
- (d) The Estate income account (5 marks)

- (e) Statement of financial position of Kombo: deceased as at 31 January 2001 (3 marks)

(Total: 20 marks)

Solution

INCOME APPORTIONMENT

- (i) Dividends from K.F.C. shares
 = 10% x par value
 = 10% x (10,000 x 20)
 = 20,000

The entire amount shall be accounted for as income since dividend received is account for as income at the point where it is received; unlike interest which accrues (and is apportioned) on a time basis.

- (ii) Interest from freehold property securities

$$\begin{array}{r}
 1/7/2000 - 31/12/2000 = 5\% \times 400,000 \times 6/12 \quad 10,000 \\
 \text{Pre-death (estate capital)} = 4/6 \times 10,000 \quad 6,667 \\
 \text{Post - death (income)} = 2/6 \times 10,000 = \quad \underline{3,333} \\
 \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \underline{10,000}
 \end{array}$$

- (iii) Interest from shares of Kombo and company

Note 5, the shares were received with interest of 5%
 Therefore 105% of the principal = 1,226,400

$$\begin{array}{r}
 \text{Principal} = \frac{1,226,400}{105} \times 100 \\
 = 1,168,000; \text{Interest} = 5\% \times 1,168,000 = \quad 58,400
 \end{array}$$

Interest for 10 months (Estate capital)

$$= 10/12 \times 1,168,000 \times 5\% = 48,667$$

$$\begin{array}{r}
 \text{Interest for 2 months } (2/12 \times 58,400) = \quad \underline{9,733} \\
 \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \quad \underline{58,400}
 \end{array}$$

JOURNAL ENTRIES

	Sh.	Sh.
1. Household furniture a/c	90,000	
Cash in house	2,000	
Cash at bank	250,000	
Investment in freehold property	300,000	
Share in Kombo & Co. a/c	1,226,400	
Debtors	20,000	
Liabilities		5,000
Provision for funeral expenses		10,000
Estate capital		2,273,400
To record the initial account balances		
2. 15 th Dec. 2000		

	Cash capital	96,000	
	Furniture		90,000
	Gain (capital estate)		6,000
	To record sale of furniture		
3.	15 th Dec. 2000		
	Cash capital	290,000	
	Estate capital	10,000	
	Share in KFC		300,000
	To record loss on disposal of investment		
4.	20 th Dec. 2000		
	Liabilities A/c	5,000	
	Provision for funeral expenses	10,000	
	Cash capital		15,000
	To record discharge of expenses above		
5.	Cash a/c capital	10,000	
	Debtors a/c		10,000
	To record receipt of a debt		
6.	31 st Dec. 2000		
	Cash capital – Estate cash book	6,667	
	Estate cash book	3,333	
	Estate capital		6,667
	Estate income		3,333
	To record interest from		
7	Cash capital (1,226,400 + 48,667)	1,275,067	
	Cash income	9,733	
	Share in Kombo & Co.		1,226,400
	Estate capital		48,667
	Estate income		9,733
	To record interest on shares of Kombo & Co.		

ESTATE CASH BOOK

2000	Sh.	Sh.		Sh.	Sh.
31/10 Estate capital	252,000		20/12 Liabilities	5,000	
15/12 Furniture a/c	96,000		20/12 Funeral expenses	10,000	
15/12 KFC Shares	290,000				
20/12 Debtors	10,000				
31/12 Invest in F Pro	6,667	<u>3,333</u>			
31/12 Inv in Kombo	1,168,000				
Invest in Kombo	48,667	<u>9,733</u>			
2001			2001		
			28/1 Distribution	20,000	
25/1 Dividends KFC		<u>20,000</u>	31/1 Bal c/d	<u>1,836,334</u>	<u>33,066</u>
	<u>1,871,334</u>	<u>33,066</u>		<u>1,871,334</u>	<u>33,066</u>

ESTATE INCOME A/C

	Sh		Sh
		31/12 Investment in Kombo & Co.	9,733
		31/12 Investment in freehold property	3,333
2001		2001	
31/1 Bal c/d	<u>33,066</u>	25/1 Investment in KFC Ltd Shares	<u>30,000</u>
	<u>33,066</u>		<u>33,066</u>

ESTATE CAPITAL ACCOUNT

2000	Sh	2000	Sh
15/12 Investment in KFC – Loss on disposal	10,000	1/1 Net estate b/d	2,273,400
31/12 Investment in Kombo	9,733	15/1 Gain on sale of furniture	<u>6,000</u>
2001		31/12 Income from property	<u>6,667</u>
28/1 Distribution	20,000	2001	
31/1 Bal c/d	<u>2,246,334</u>		
	<u>2,286,067</u>		<u>2,286,067</u>

Kombo (deceased) Died on 31 October 2000**Statement of financial position****As at 31 January 2001**

	Sh.	Sh.
Capital assets		
Investment on freehold property securities	400,000	
Sundry debtors (20,000 – 10,000)	10,000	
Cash at bank/in hand	<u>1,836,334</u>	2,246,334
Income assets		
Cash at bank or in hand		<u>33,066</u>
		2,279,400
Estate capital		2,246,334
Estate income		<u>33,066</u>
		<u>2,279,400</u>

REINFORCING QUESTIONS

QUESTION ONE

Andrew, a widower, died on 28 February 20X4, and by his will executed ten years earlier made the following bequests:

- (a) 'To my brother George, my record collection.'
- (b) 'To my brother David, on his wedding day, Shs.50,000.'
- (c) 'To my dearest sister-in-law, my furniture and other personal chattels, not otherwise bequeathed.'
- (d) 'To my nephew Peter, a Mini Metro motor car.'
- (e) 'To my niece Sandra, Shs.200,000 payable out of my account with the Lukenya Building Society.'
- (f) 'To my nephew Timothy, Shs.100,000 in my deposit account at Trust Bank.'
- (g) 'To my cousin Patrick, my 1,000 ordinary shares in Kakuzi Ltd.'
- (h) 'To the All Saints Cathedral, Shs100,000 for the refurbishment of the choir stalls.'
- (i) 'To each of my sons Edward and Francis, Shs.1.5m.'
- (j) 'The residue of my estate on trust to provide an annual income for my daughters Barbara and Caroline, until they marry, and thereafter to my grandchildren in equal shares.'

You ascertain the following:

- i. George and Edward both predeceased Andrew. Each had two children living at the date of Andrew's death.
- ii. David is a confirmed bachelor. He declares that 'having failed to get me married while he was alive, Andrew will not bribe me into marriage now he is dead.'
- iii. Andrew had three sisters-in-law, all of whom he saw regularly prior to his death.
- iv. At the date of the will Andrew had owned a Datsun car, two years ago he replaced it with a Toyota; he has never owned a Mini Metro car.
- v. The Lukenya Building Society account had been closed on 30 September 20X3.
- vi. On 28 February 20X4 there was only Shs.72,000 in the deposit account at Trust Bank.
- vii. Kakuzi Ltd had converted each of its Shs.20 ordinary shares into 4 units of Shs.5 ordinary stock in October 20X2. Andrew owned exactly 4,000 units of Kakuzi Ltd ordinary stock at the date of his death.
- viii. The choir stalls at the All Saints Cathedral had been refurbished fully the previous autumn at which time Andrew had contributed Shs.120,000 to the Refurbishment Fund.
- ix. Both Andrew's daughters had married prior to his death and Andrew had a total of five grandchildren alive at 29 February 20X4, the eldest of whom was eight years of age.
- x. In addition to the assets specifically referred to above, Andrew's estate also included a freehold house together with cash and investments totalling Shs.7m, after payment of debts and funeral expenses.

Required:

In relation to each bequest in Andrew's will, state the type of legacy referred to and explain whether or not the executors should give their assent to the gift. (Total: 20 Marks)

QUESTION TWO

Robin (aged 54) died in a road accident on 31 December 20X1. On 1 May 20X2 after his executors had paid all his debts, (except for the mortgage on his freehold house referred to below) testamentary and funeral expenses, his estate was ascertained as follows:

	Shs'000	Shs'000
Cash on bank accounts		8,500
Freehold house		6,500
Jaguar motor car		720
Mercedes motor car		1,260
Stamp collection		850
Debt due from William		120
Furniture and other personal effects		1,345
10,000 Ordinary Shs.10 shares in Kenya Breweries Limited		1,200
4,500 Ordinary Shs.10 shares in Nation Printers Limited		740
Shs.800,000 5% Kenya Stock		235
Income received to date:		
Bank interest	230	
Dividend from Nation Printers Limited	<u>37</u>	
	267	
Less: Mortgage interest paid 31 March 20X2	<u>120</u>	
		147

Extracts from Robin's will left bequests as follows:

- (a) 'To my wife Annie, I leave my furniture and other personal effects and the residue of my estate, after payment of my debts and expenses.'
- (b) 'To each of my sons, David, Jack and Stuart, Shs.1m.'
- (c) 'To my unmarried daughter, Clare, my freehold house subject to any mortgage thereon.' The house was subject to a mortgage of Shs.2m. carrying interest at 12% per annum payable 31 March and 30 September.
- (d) 'To my friend Tony, whichever of the motor cars owned by me at the time of my death he may choose.'
- (e) 'To my good friend Gerry Gangla, Shs.100,000.'
- (f) 'To my friend Ben, some of my furniture.'
- (g) 'To my cousin Susan, my painting of the "Street Scene" by Renoir.'
- (h) 'To my friend Dennis, Shs.200,000 on condition he gives up the bad habit of smoking.'
- (i) 'To my brother Joseph, 1,000 shares in Brooke Bond(K) Ltd.'
- (j) 'To my sister Elsie, Shs.600,000.'
- (k) 'To my secretary Betty, half of my holdings of Ordinary Shs.10 shares in Kenya Breweries Ltd.'
- (l) 'To my cousin Miriam, my holding of Shs.800,000 5 1/2% Kenya Stock and my holding of shares in Cassava Ltd.'
- (m) 'To my chauffeur, Malcolm, Shs.300,000.'
- (n) 'To my gardener Jeremiah, Shs.150,000 if still in my employ at the death of my death.'
- (o) 'To my friend Eric, my 6,000 Ordinary shares in Printers Ltd.'
- (p) 'To my nephew Frank, 4,000 Ordinary Shs.10 shares from my holding of such shares in Kenya Breweries Ltd.'
- (q) 'To my niece Tracey, Shs.200,000 payable out of my holding of Shs.10 Ordinary shares in Kenya Breweries Ltd.'
- (r) 'To my friend Timothy, Shs.150,000.'
- (s) 'To my cousin Hazel, the Shs.120,000 which William owes me.'
- (t) 'To St. Peter's Church Shs.100,000 to provide a stained glass window in memory of my mother.'

- (u) 'To my good friend Gangla Shs.150,000 for looking after my house for many years when I went on holiday.'

Robin's executors ascertained that the following beneficiaries were dead:

- Son Jack, died 1989, leaving a wife and two children.
- Son Stuart, died 1988, leaving a wife.
- Sister Elsie, died 20x6, leaving a husband and two daughters.
- Chauffeur Malcolm (aged 60) killed in the same accident as Robin. It was impossible to determine the order in which Robin and Malcolm died.

The executors also advise you that:

- i. Tony elected to have the Mercedes car.
- ii. Robin sold the Renoir painting in 1987 for Shs.3m.
- iii. Dennis replied in a letter to the executors that he had no intention of giving up smoking.
- iv. Robin owned no shares in Brooke Bond Ltd. The value of 1,000 shares in that company is Shs.330,000.
- v. There is no such investment as 5 1/2% Kenya Stock. The reference in Robin's will to 5 1/2% is thought to be a typing error not previously noticed.
- vi. Robin sold his shares in Cassava Ltd. using the proceeds of Shs.900,000 to purchase his shareholding in Kenya Breweries Ltd.
- vii. The gardener Jeremiah retired in June 20X0.
- viii. In early 1990, Printer Ltd. merged with Nation Ltd. to form a new company Nation Printers Ltd. and Robin received 4,500 new Ordinary shares in Nation Printers Ltd. in exchange for his 6,000 Ordinary shares in Printers Ltd.
- ix. Timothy replied in a letter that he 'didn't' want anything from Robin's estate because actually he hated the sight of him.'
- x. In 1989 Robin had paid Shs.125,000 for a stained glass window in St. Peter's church in memory of his mother.
- xi. His daughter Clare had married in April 1989.
- xii. Gerry Gangla claimed both legacies.

Required:

- (a) A statement showing the distribution of Robin's estate on 1 May 20X2. (12 Marks)
 - (b) A list of legacies to which the executors should not assent, briefly explaining the reason why the legacy is invalidated. (8 Marks)
- (Total: 20 Marks)**

QUESTION THREE

Estate Duty is not charged in Kenya at the present time. Estate Duty is included in the following questions to show how it would be accounted for.

Jackson died (intestate) on 1 April 20X8, survived by his widow and two infant children, Janet and James.

His estate consisted of:

	Kshs.
Kshs.28,000 9% Funding Stock 20X6 - X8 (interest 1 February and 1 August)	23,100
Kshs.24,000 2 1/2% Savings Bonds 20X4 - X7 (interest 1 May and 1 Nov.)	20,020
Policy on his life for	30,000
Building society deposit at 8% (interest 1 January and 1 July)	4,500
Accrued interest thereon	90
Balance at bank	4,735
Household furniture and effects	<u>3,000</u>
	85,445
Less: Debts and funeral expenses	<u>650</u>
	Kshs.84,795

Interest on the Government Stocks was received on the due dates.

In addition, the following transactions took place during the year ended 31 March 20X9:

20X8

31 May	Estate Duty of Kshs.11,163 was paid by means of a temporary overdraft at the bank.
15 June	The sum assured by the life policy was received.
30 June	The building society deposit was repaid to the personal representative, together with interest to date.
12 July	Kshs.18,000 9% Funding Stock 20X6 - X8 was sold ex interest due 1 August, the net proceeds amounting to Kshs.14,760.
10 August	The debts and funeral expenses were paid.
30 September	The bank debited the personal representative's account with interest amounting to Kshs.67 (chargeable to income).
2 October	Effect was given to the widow's statutory rights in the capital of the estate.

20X9

31 January	Administration expenses of Kshs.400 (all chargeable against capital) were paid.
------------	---

You are required to:

- Write up the cash book and estate capital account for the year ended 31 March 20X9; and
- Prepare the statement of financial position as on that date, the widow and children being still alive.

Ignore income tax.

(15 Marks)

QUESTION FOUR

When Neville died on 1 May 20X8; his estate for probate purposes was as follows:

	Kshs.
4,000 ordinary shares of 25p each in Weasel Income statement - quoted 73p-77p	2,960
7,000 ordinary shares of Kshs.1 each in Mouze Income statement - quoted 342p-346p	24,010
4,000 ordinary shares of 50p each in Frog Ltd. - valued at	4,600
1,000 ordinary shares of Kshs.1 each in Rat Ltd. - valued at	8,000
Middling Building Society - ordinary share account	25,000
- interest accrued to date	654
Balance at bank	32,000
Personal chattels	2,000
Office building owned jointly with Beakie, who takes as survivor - valued at	40,000
Debts and funeral expenses	490

Neville's will provides:

1. That the following legacies be paid immediately:
 - i. To my wife Gloria the sum of Kshs.30,000 together with my personal chattels;
 - ii. To Beakie my holding of shares in Rat Ltd;
 - iii. To Greta my country cottage;
 - iv. To my friend Harold the sum of Kshs.10,000;
 - v. To my sister Edna the sum of Kshs.15,000.

2. That the executors have full discretionary powers investment, and after paying all debts duties and legacies, the balance is to be held in trust for the benefit of my children absolutely in equal shares until they attain the age of eighteen years.'

You also obtain the following information:

- i. Edna died on 1 April 20X8.
- ii. The country cottage was sold in 20X7 for Kshs.20,000.
- iii. Neville is survived by his wife Gloria and two sons, David and Donald, who are aged 16 and 14 years respectively.
- iv. Neville had not made any chargeable transfers during his lifetime.

20X9

January 31	Received dividend of 15p per share on holding in Owl Income statement for year to 30 November 20X8. Received interim dividend of 16p per share on holding in Mouse Income statement for year to 31 January 20X9.
February 28	Received final dividend of 6p per share on holding in Weasel Income statement for the year to 31 December 20X8.
April 30	Paid administration expenses Kshs.1,700 (capital Kshs.1,500; income Kshs.200).

You are required to prepare for the year ended 30 April 20X9:

- | | |
|--|-----------|
| (a) Estate Capital Account; | (7 Marks) |
| (b) Estate Income Account; | (2 Marks) |
| (c) Estate Cash Account; and | (8 Marks) |
| (d) Statement of financial position as on that date. | (3 Marks) |

Note: Ignore income tax.

(TOTAL 20 Marks)

QUESTION FIVE

Walter died on 1 February 20X8 leaving the following estate:

	Probate value
	Kshs.
Building society deposit	5,042
Interest accrued to date	39
Balance at bank	4,965
Personal chattels	3,600
Freehold house	24,000
Kshs.60,000 10% Government Stock	42,000
7,000 ordinary shares of Kshs.1 each in Walters Ltd	10,000
3,000 ordinary shares of Kshs.1 each in Charles Ltd	3,000

Debts and funeral expenses amounted to Kshs.1,046.

His will included the following legacies:

- i. To his wife, Jane the freehold house, personal chattels, the ordinary shares in both Walters Ltd. and Charles Ltd., and the sum of Kshs.15,000 (note: transfers between spouses are exempt from Estate Duty);
- ii. To his daughter Susan, his country cottage and the sum of Kshs.21,600;
- iii. To his sons George, Harold and Frederick the sum of Kshs.12,000 each;
- iv. To his sister Josephine the sum of Kshs.10,000;
- v. To his friend Charles the sum of Kshs.2,400;
- vi. To his brother Victor his holding of Kshs.5,000 Savings Bonds.

His will also directed that the residue and any income arising during the administration of the estate should go to his wife Jane.

You ascertain that the country cottage was sold for Kshs.15,000 in 20X6 and the Savings Bonds encashed in 20X7. His sister Josephine had died in 20X5 and his son Harold died in 20X4, leaving two sons John and Philip. All beneficiaries are of full age.

The following transactions took place during the three month period ended 30 April 20X8:

28 February	Received dividend of 10p per share for the year ended 31 March 20X7 on shares in Walters Ltd.
31 March	Received proceeds of sale of Government Stock Kshs.41,000. Paid Kshs.2,250 Estate Duty, being the whole amount arising on death.
30 April	Withdrew balance of Kshs.5,157 from building society account including interest to date. Paid debts and funeral expenses. Distributed all legacies and completed the administration of the estate.

You are required to prepare the Estate Capital Account and Cash Account for the period ended 30 April 20X8, showing the administration of the Estate.

Ignore Income Tax.

(20 Marks)

CHECK YOUR ANSWERS WITH THOSE GIVEN IN LESSON 9 OF THE STUDY PACK

COMPREHENSIVE ASSIGNMENT NO. 3
TO BE SUBMITTED AFTER LESSON 6

To be carried out under examination conditions and sent to the Distance Learning Administrator for marking by the University.

TIME ALLOWED: THREE HOURS.

ANSWER ALL QUESTIONS

QUESTION ONE

Korir carrying out a business as a trader in Nairobi finds himself insolvent and on 15 March 2001 files his own petition in bankruptcy. The following balances are extracted from the books of his business on that date:

	Sh.		Sh.
Capital	180,000	Shop, loan and buildings	600,000
Mortgage on shop –land and building	450,000	Furniture and fittings	150,000
Loan ICDC	180,000	Stock of goods	81,405
Loan – Barclays Bank	90,000	Debtors	96,195
Loan – Co-operative Society	30,000	Korir – drawings	197,100
Loan – A Kariuki	15,000	Cash in hand	300
Loan – W. Kuria	3,000		
Trade creditors	171,000		
Salaries, wages payable	2,700		
NHIF, NSSF, PAYE	540		
Bank overdraft	<u>2,7600</u>		
	<u>1,125,000</u>		<u>1,125,000</u>

The following additional information is available:

1. Trade creditors include Sh.4,500 owing to Nairobi City council in respect of rates for the current period and a small loan from his friend Macharia Sh.1,500.
2. The amount owing for salaries, wages and payroll deductions are for 2001
3. There is Sh.31,500 interest unpaid on the mortgage as at 15 March 2001 which has not been recorded in books.
4. The loan from ICDC is secured by a second mortgage on the shop, land and building. The unrecorded interest owing as at 15 March 2001 is Sh.14,400.
5. The loan from the Co-operative society was obtained when Korir pledged his wholly owed farm as security. The farm is valued at Sh.45,000. There is no interest outstanding on his loan.
6. The interest on the loan from A Kariuki was to vary with profits, but since the business has been operating at loss, there is no interest due.
7. There is no interest outstanding on the loan from Barclays Bank.
8. W. Kuria is Korir's brother-in-law.
9. The value assets are estimated to be:

	Sh
Shop, land and building	630,000
Furniture and fittings	120,000
Stock of goods	30,000

10. Of the debtors, Sh.60,000 are thought to be good and Sh.30,000 doubtful of which Sh.22,500 should be collectable.

11. Korir's uncle died recently and he will be receiving Sh.7,500 as an inheritance.
12. Korir has no personal creditors outside the business but he has other personal assets as well as the small piece of land amounting to Sh.9,000 exclusive of household and personal effects.

Required:

- (a) A statement of affairs for Korir as at 15 March 2001 in good form (10 marks)
 - (b) A deficiency account. (8 marks)
 - (c) A detailed listing of the amounts you have included as unsecured preferential creditors (2 marks)
- (Total: 20 marks)

QUESTION TWO

A creditor of Polepay Traders, a partnership owned by Peter Ole Lemasio and Patrick Ayimba, presented a petition in bankruptcy against the partnership on 1 April 2001. On 30 April 2001, the High Court made out a Receiving order against the partnership and the two partners.

The statement of financial positions of the partnership and the individual partners as at 30 April were as follows:

Assets:	Polepay Sh. '000'	Lemasio Sh. '000'	Ayimba Sh. '000'	Liabilities:	Polepay Sh. '000'	Lemasio Sh. '000'	Ayimba Sh. '000'
Land and building	12,450			Bank overdraft	4,600		
Houses		5,500	4,800	Creditors	27,270	670	450
Plant & Equipment	14,600			Long-term loans	11,200	3,300	3,840
Furniture, etc,		650	400	Car loans		380	600
Inventory	19,600			Excess of assets			
Trade receivables	20,240			Over liabilities	24,000	15,990	15,550
Cash	180	90	140				
Investments		13,600	14,200				
Motor cars		500	900				
	<u>67,070</u>	<u>20,340</u>	<u>20,440</u>		<u>67,070</u>	<u>20,340</u>	<u>20,440</u>

Additional information:

1. Lemasio and Ayimba have contributed equal amounts of capital to the partnership; always draw the same amount from the partnership and share profits and losses equally. The partners' capital included in their personal assets under the title investments,
2. The estimated realizable values of the assets stated above are as follows:

Assets:	Polepay Sh. '000'	Lemasio Sh. '000'	Ayimba Sh. '000'
Land and building	8,000		
Houses		4,000	3,500
Plant and Equipment	7,500		
Furniture		180	100
Inventory	13,500		
Trade receivables	13,100		
Other investments		700	1,000
Motor cars		250	300

3. The long term loan in the books of the partnership is secured on the partnership land and buildings. The long-term loan to the individual partners are secured on the individual partner's houses. The partnership overdraft was secured by a second mortgage on the partnership land and building and by the personal guarantee of Ayimba and the deposit of his investments. The car loans are secured on the partners' car individually.
4. Of the sectors of Polepay, Lemasio and Ayimba, preferential creditors amounted to Sh.20,000, Sh.590,000 and Sh.380,000, respectively, and represent amounts due for taxation.

Required:

Prepare statements of Affairs and Deficiency or surplus Accounts for the partnership and for the individual partners, using the format laid down in the Bankruptcy Act and showing the legal position.

(20 marks)**QUESTION THREE**

A trading company Endesha Ltd. has experienced severe financial difficulties in recent times and is currently insolvent. A voluntary winding up petition will soon be filed and management is considering either liquidation or reorganisation. The chief accountant has produced the following statement of financial position as if the company were a going concern:

Statement of financial position as at 31 March 1999

	Sh. '000'		Sh. '000'
Ordinary share capital	100,000	Fixed assets:	
Retained earnings (deficit)	<u>(64,000)</u>	Land	100,000
	36,000	Building (NBV)	110,000
Long term liabilities:		Equipment (NBV)	80,000
Note payable (secured by lien on land and buildings)	200,000	Intangible assets	<u>15,000</u>
			305,000
Current liabilities:		Investments in securities	15,000
Creditors	60,000	Current assets:	
Accrued expenses	18,000	Stocks	41,000
Note payable (secured by stocks)	75,000	Debtors	23,000
		Prepaid expenses	3,000
		Cash at bank	2,000
	<u>389,000</u>		<u>389,000</u>

Additional information

1. The land and buildings are in the prime location and can be sold for 10% more than their book value. But the equipment may not get a buyer unless the price is reduced. It is expected to fetch only 40% of its current book value.
2. Administrative costs of Sh.21.5 million are projected if liquidation of the company does occur.
3. By spending Sh.5 million for repairs and marketing costs, stocks currently held can be sold for Sh.50 million.
4. Accrued expenses include salaries of Sh.13 million. Of this figure, one executive is owed a total of Sh.3 million but is the only employee whose amount due is in excess of the statutory limit. Payroll taxes withheld from salaries and wages but not yet remitted to the Kenya revenue Authority total Sh.3 million. However, company records currently show only Sh.1 million portion of this liability.

5. The investments reported on the statement of financial position have appreciated in value since acquisition and are now worth Sh.20 million. Dividends of Sh.500,000 are currently due from these investments, but not yet recognised.
6. Interest of Sh.5,000,000 on the long-term liabilities has not been accrued for the current financial year.
7. Debtors are estimated to be collectible for Sh.12 million.
8. A refund of Sh.1 million will be received from the various prepaid expenses but the company's intangible assets have no resale value.

Required:

A statement of affairs in accordance with the requirements of the company's Act, 1948, for 31 March 1999. (20 marks).

QUESTION FOUR

Matatizo Ltd. went into voluntary liquidation on 30 November 2003. Its statement of financial position as at that date was as follows:

	Sh.
Assets:	
Land and building	5,000,000
Plant and machinery	12,500,000
Patents	2,000,000
Stock	2,750,000
Sundry debtors	5,500,000
Cash at bank	1,500,000
Income statement balance	<u>5,625,000</u>
	<u>34,875,000</u>

Equity and liabilities:

Issued and subscribed capital	
100,000 10% cumulative preference shares of Sh.100 each, fully paid	10,000,000
50,000 equity shares of Sh.100 each, Sh. 75 paid	3,750,000
150,000 equity shares of Sh.100 each, Sh. 60 paid	9,000,000
15% debentures secured by floating charge	5,000,000
Interest outstanding on debentures	750,000
Creditors	<u>6,375,000</u>
	<u>34,875,000</u>

Additional information:

1. Preference dividends were in arrears for two years and the creditors included preferential creditors of Sh.760,000.
2. The assets were realized as follows:

	Sh.
Land and building	6,000,000
Plant and machinery	10,000,000
Patents	1,500,000
Stock	3,000,000
Sundry debtors	4,900,000

3. Liquidation expenses amounted to Sh.545,000. The liquidator is entitled to a commission of 3% on assets realized except for the above.

4. The final payments (including those relating to debentures) were made on 31 May 2004.

Required:

The liquidator's final statement of account as at 31 May 2994.

(Total: 15 marks)

QUESTION FIVE

- (a) Explain the term abatement and rule of lapse as used in accounting for executorships (5 marks)
 (b) Kombo died on 31 October 1999 and was survived only by Kwetu his grandson. By his will which barred equitable apportionment and was silent on the date of payment of legacies he left his estate as follows:

To my cousin Musa my beach plot
 To my friend Naomi my car
 To my nephew Penny my boat
 To each of my brother-in-law Sh.40,000
 To each of my two sons Sh.200,000
 To my housekeeper Ali if still in my employment Sh.400,000
 To the pastor of my church Paul Sh.100,000
 To my local church Sh.100,000 to buy a piano in memory of my late mother.
 To my shamba boy, Juma if still in my employment Sh.40,000.
 To each of my neighbours Faith, Peter and Tom Sh.20,000;
 To the water games club, my outboard engine; and
 To my grandson Kwetu, the residue absolutely.

On 30 April 2000, the executors, having paid all the liabilities of the estate and the expenses of administration were ready to assent to the legacies. The property in their possession and its value at the date was:

	Sh.
Car (van)	180,000
Car (saloon)	100,000
Boat	50,000
Furniture, jewellery etc	190,000
Farm	80,000
Beach plot	24,000
Sh.3,000,000 6% Government stock	2,400,000
Balance at bank	<u>1,376,000</u>
	4,400,000

The following additional information is available:

- Penny died on 30 March 1999.
- Kombo had two brothers in law surviving at 31 October 1999.
- Ali was still employed at 31 October 1999
- During his lifetime, Kombo provided his church with a local piano in memory of his late mother
- Juma retired on 31 October 1997.
- Faith and Juma both predeceased Kombo.
- The farm had been purchased by Kombo with proceeds of the sale of the outboard engine.

Required:

A schedule showing the distribution of the estate. Give your reasons should you decide that the executors should assent to any legacies (ignore taxation)

**END OF COMPREHENSIVE ASSIGNMENT No. 3
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LESSON SEVEN

TRUST LAW AND ACCOUNTS

OBJECTIVES

At the end of this lesson, you should:

- Know the law of trusts;
- Know how to prepare trust accounts.

CONTENTS

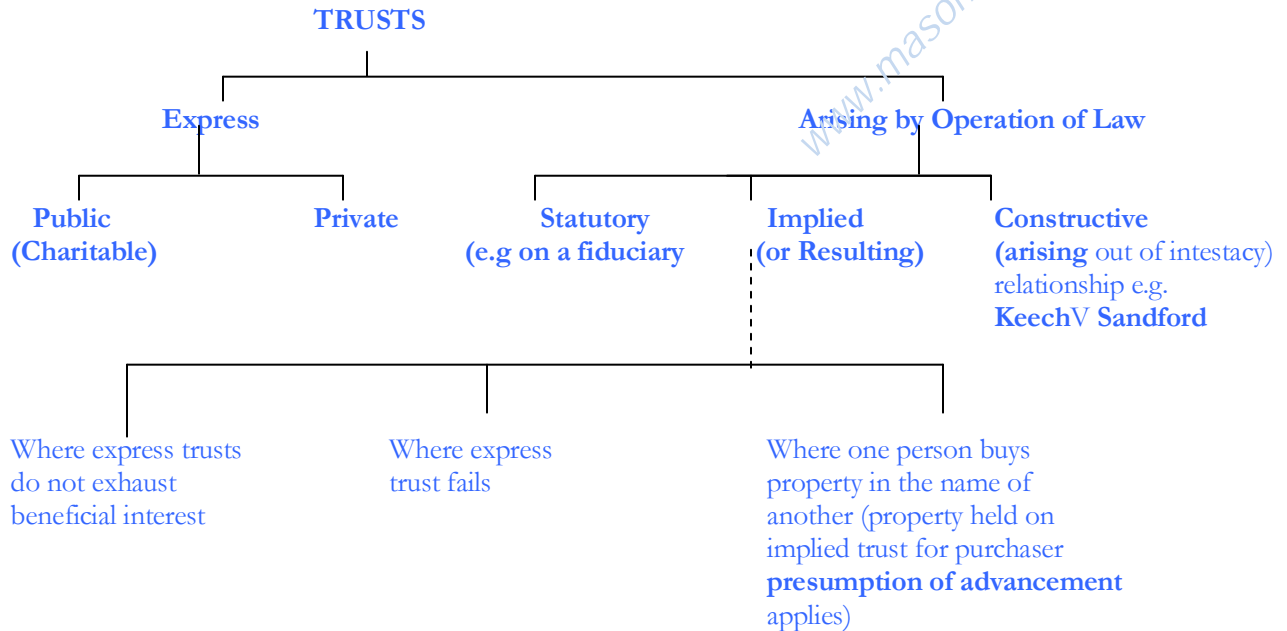
- Read the study text below.
- Attempt reinforcing questions at the end of the lesson.
- Compare your solutions with those given in Lesson 9.

STUDY TEXT

DEFINITION

There is no generally accepted definition of a trust, although many have attempted. Underhill defines a trust as "an equitable obligation binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property) for the benefit of the persons (who are called the beneficiaries) of whom he may himself be one, and any one of whom may enforce the obligation".

8.2 CLASSIFICATION



8.3 EXPRESS TRUSTS

(a) Creation

An express trust is "created not by facts and circumstances, but by the express words of the settlor". (**Fitzgerald v Stewart**)

It may be created in the following ways:

1. A declaration of trust by the **settlor** whereby he makes himself the trustee of property for the benefit of some person; or
2. The transfer by the **settlor** of the ownership of the trust property to trustees, and the communication to the trustees of the terms upon which they are to hold that property; or
3. By will.

(b) Completely and incompletely constituted trusts

In all cases the trust must be completely constituted. A trust is completely constituted when the trust property has been vested in trustees for the benefit of the beneficiaries. Where there is merely a contract or covenant to create a trust, the trust is said to be incompletely constituted.

A completely constituted trust may be enforced by **any** beneficiary, including a volunteer; an incompletely constituted trust can only be enforced by a beneficiary who has given value. Thus a trust is incompletely constituted where there is merely a covenant by a settlor to settle property which he expects to acquire. If the settlor does not settle the property when he eventually acquires it, although he will be liable in damages to the intended beneficiaries, if they were parties to the covenant, and the covenant was under seal, those beneficiaries, if volunteers, cannot enforce their expected beneficial interest in the property to be settled. (**Jeffreys v Jeffreys**)

(c) Form

No special form is normally required for the creation of a trust except that a declaration of trust respecting land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will:

The following points should be noted:

1. Applies to "land or any interests therein". No writing is necessary to create an inter vivos trust of pure personality.
2. This does not affect the creation or operation of resulting, implied or constructive trust;
3. A trust caught by this provision need not be declared by writing; it need only be evidenced (i.e. proved by some writing);
4. Absence of writing does not render the declaration of the trust void, merely unenforceable;
5. The writing must contain all the material terms of the trust;
6. The writing must be signed by some person who is able to declare the trust: the signature of an agent is unacceptable;
7. A trust of any property to arise on death must be created by will.

(d) The three certainties

A trust will be valid only if the three certainties are present i.e. certainty of words, certainty of subject, and certainty of objects.

1. Certainty of words

- i. There is no need for a settlor to use the word "trust" in order to constitute a trust; it is enough if the words used in the instrument clearly establish an intention to create a trust.
- ii. The words must be imperative and not merely a request i.e. precatory words. **(Re Adams and the Kensington Vestry)**

2. Certainty of subject matter

- i. Where the property subject to the purported trust cannot be identified there will be no trust. **(Sprange v Barnard)**.
- ii. Where the beneficial interests to be taken by the beneficiaries are not certain, the trust will a resulting trust for the settlor **(Boyce v Boyce)**.

However there is no uncertainty in the following cases:-

- a. Where the trustees are empowered to determine the beneficial interest to be enjoyed;
- b. Where the court is able to apply the maxim "Equality is Equity", and divide the property into equal shares.

3. Certainty of objects

The objects of a trust must be certain i.e. a trust will only be valid if it can be said with any certainty that any given individual is or is not a member of the class of beneficiaries. Generally, trusts which fail to meet this requirement are void for uncertainty.

Charitable trusts constitute an exception to this rule. However, such trusts do fail if the gift is not exclusively for charitable purposes **(Re Astor's Settlement Trusts)**.

(e) Absence of the certainties

- i. In the absence of certainty of words the donee generally takes beneficially.

- ii. In the absence of the other certainties there is generally a resulting trust in favour of the settlor or his estate.

4 SECRET TRUSTS

(a) Introduction

The initial basis of the doctrine of secret trusts was the refusal of equity to permit a statute to be used as an engine of fraud (**e.g. Bannister v Bannister**). Certain formalities are necessary for the creation of **inter vivos** trusts of land for testamentary dispositions. A trust of land must be evidenced in writing; and all testamentary dispositions must comply with the Law of Succession Act. In the case of wills, secret trusts are of two types, fully secret trusts and half secret trusts.

(b) Fully secret trusts

This is where neither the existence nor the terms of the trust are disclosed in the will. The trust will be enforced only if the following conditions are complied with.

1. The testator must leave property by will to the secret trustee apparently for his own benefit;
2. The testator must tell the secret trustee that he wants him to hold the property on trust for the secret beneficiary: this communication must take place during the testator's lifetime: but whether it is before or after the date of the will is immaterial;
3. The secret trustee must promise to carry out the testator's intention: such promise may be express or implied: silence after hearing the testator's intention will normally be treated as an implied promise (*moss v cooper*);
4. The testator's decision to make a disposition in favour of the secret trustee or to leave an existing disposition unaltered must be made on the faith of the secret trustee's promise;
5. No trust will arise if the alleged trustee only learns of the alleged trust after the testator's death (*wallgrave v tebbs*)

(c) Half secret trusts

In this type of trust the will states that the gift is on trust, but the name of the beneficiary is not specified. Since the existence of a trust is disclosed, the trustee is unable to claim the property for himself. The following points should be noted:-

1. Evidence tending to establish a half-secret trust is inadmissible if it contradicts the terms of the will (*Re Keen*);
2. Communication of the trusts to the trustees will be ineffective if it takes place after the will has been executed (*Johnson v Ball*);
3. Where there is no proper communication to the trustees, the property belongs to the residuary legatee or, if no such person, the testator's next of kin (*Johnson v Ball*).

Note Secret trusts operate outside the will. Thus:

- (a) A beneficiary under a secret trust does not lose his interest if he witnesses the will or if he predeceases the testator;
- (b) Where a secret trustee predeceases the testator, the legacy and the trust fail.

8.5 PROTECTIVE TRUSTS

The income of property may be settled on such terms as to restrict its availability to creditors of the beneficiary in the following ways:

(a) Determinable interests

In this case the interest of the beneficiary ceases on **alienation or bankruptcy**. Note that a person cannot settle property on **himself** until bankruptcy since this would defeat the claims of his creditors.

(b) Discretionary trusts

In this case the trustees have a complete discretion whether to pay the income to the beneficiary or not.

(c) Protective trusts

If income is settled on "protective trusts", this operates to give –

1. A life interest for the principal beneficiary **determinable** on alienation or bankruptcy; and thereafter;
2. A **discretionary** trust for the trustees to apply the income for the benefit of the principal beneficiary, his spouse and issue, or, if there is no spouse or issue then for the benefit of the principal beneficiary and those who would be entitled to the trust property or the income thereof were he dead (S.35 Trustee Act, Cap.167).

8.6 IMPLIED TRUSTS**(a) Definition**

An implied trust arises where the settlor's intention is inferred from his words and his conduct (**Barclays Bank Ltd. v Quistclose Investments Ltd.**)

Some implied trusts are also called "resulting trusts": this is because the beneficial interest results to the settlor.

(b) Resulting trusts

Resulting trusts occur **where equity regards the property which is held by a trustee as belonging in equity to the person who transferred it to, or caused it to be vested in, the trustee.**

They may arise in four situations -

1. Purchase of property by one person in the name of another
 - i. Where a person buys land or pure personalty and has it conveyed into the name of another, or into the joint names of himself and another, there is a presumption that **the property is held on trust for the person supplying the purchase money;**
 - ii. If two people advance money to purchase property, but the conveyance is taken **in the name of one only, the other takes a beneficial interest in the property in proportion to the money advanced by him.**
In some cases the relationship between the two parties will raise **a presumption of advancement which displaces the presumption of a resulting trust** i.e where the person supplying the purchase money is under an obligation to maintain the other e.g. a father or a husband.
2. **Voluntary transfer** of personal property by the owner into the name of another or into their joint names (**e.g Re Vinogradoff**).
3. Failure to exhaust the beneficial interest. The settlor fails to dispose of the **whole** of the beneficial interest in the trust fund. **The undisposed of part** is held by the **trustees on resulting trust for the settlor or his estate (Re Abbots Fund)**.
4. Where a **private express trust fails for uncertainty** of objects or **for non-compliance with statutory formalities** there will be a resulting trust in favour of the settlor.

8.7 CONSTRUCTIVE TRUSTS

A constructive trust is a trust imposed by equity regardless of the intention of the owner of the property: it arises by operation of law. The concept has been applied in a number of situations:

1. It is a rule of equity that a trustee must not permit his interests to conflict with his duties: note particularly, a trustee may not profit from his trust: where he does so he holds the gains on a constructive trust (**Keech v Sandford**);
2. If a person who is not a trustee obtains information with the help of a trustee which enables him to make

- a profit, he holds the proceeds on constructive trust: **(Boardman v Phipps)**;
3. If a person receives trust property with knowledge (actual or constructive) that it is trust property, and it is transferred to him in breach of trust, he holds the property as trustee;
 4. A person who does not actually receive trust property but assists a trustee to fraudulently dispose of it is liable as a trustee.

Note Strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, e.g a solicitor who creates a fraudulent document on the instructions of the trustee. They will be liable only if:-

- (a) They receive the trust property; or
- (b) Act in a manner consistent with that of a trustee; or
- (c) Assist with knowledge in a dishonest and fraudulent design on the part of the trustees.

8.8 APPOINTMENT OF TRUSTEES

(a) Capacity

Any person with legal capacity to hold property may be a trustee, except an **infant**. But the court will not appoint, and may remove:

1. Persons under a **disability**;
2. Persons **resident abroad**; or
3. **Beneficiaries** or their **spouses or solicitors**.

(b) Numbers

If the trust property includes **land**, the maximum number is **four** (in the case of a **private** trust; (s.36) and the **minimum two, or a trust corporation (a sole trustee cannot give a receipt for capital money arising under a trust for sale of land or under a settlement of land; s.15**. If not, there is no maximum or minimum number, but:

1. **Additional** trustees may **not** be appointed to **take the number above four, and**
2. A trustee **cannot retire** to leave **only one trustee, unless a sole trustee was originally appointed**.

(c) Original trustees

These are appointed by the **settlor**; if he fails to appoint, he or his personal representatives act as trustees. The settlor has **no power to make subsequent appointments unless he reserves the power to do so**.

(d) New trustees

New trustees may be appointed **in writing** to replace a trustee who:

1. Is dead;
2. Remains continuously out of kenya for more than one year;
3. Desires to be discharged;
4. Refuses to act;
5. Is (legally) unfit to act, e.g. Bankrupt;
6. Is (physically) incapable of acting, e.g. infirm; is removed under a power in the trust instrument; or being a corporation, is dissolved.

The appointment is made by:-

1. Persons having power to appoint under the trust instrument; or if no such person, or no such person is willing and able to appoint, then
2. The surviving trustee or trustees; or
3. The personal representatives of the last trustee. S.37 (1) – (3)

(e) Additional trustees

Apart from the appointment of the trustees (above), additional trustees may be appointed in writing at any time by:

1. Persons given power to appoint by the trust instrument; or if no such person willing and able to act then
2. The trustees for the time being; provided that –
 - i. No existing trustees is **a trust corporation; and**
 - ii. The total number of trustees will not exceed **four**.

(f) **Appointment by court**

The court may appoint trustees:

1. Whenever it is **difficult, inexpedient or impracticable** to appoint without the court's assistance, on the application of a trustee or a beneficiary e.g. in substitution for a trustee who is **bankrupt, mentally defective or a convicted criminal S.42**.
2. A judicial trustee (an officer of the court), on application by settlor, trustee or beneficiary, in substitution for all or any of the existing trustees;
3. The public Trustee, on application of a trustee or beneficiary even though this is forbidden in the trust instrument.

(g) **Appointment by beneficiaries**

The beneficiaries have no power to appoint or to direct the trustees to do so (e.g. re Brockbank) but –

1. If all are sui juris and absolutely entitled, they may terminate the trust; and otherwise
2. They may apply to the court to appoint or remove a trustee (see above).

8.9 TERMINATION OF APPOINTMENTS

A trustee may cease to hold office in the following ways:

(a) **Disclaimer**

At any time before acceptance of the trusts.

(b) **Retirement**

Either –

1. Under the trust instrument; or
2. With the consent of all beneficiaries, being sui juris, or
3. With the consent of the court; or
4. By **deed** under S.40, provided that –

- i. There remain a trust corporation or at least two trustees; and
 - ii. He obtains consent **by deed** of his co-trustees and of any person with power to appoint new trustees.
- (c) **Release and replacement**
This may take place under S.37 (see paragraph 8.8 (d) above).
- (d) **Removal**
The trustee may be removed by the court under its inherent power to protect beneficiaries, even though he may have committed no breach of trust.
- (e) **Discharge**
The trustee is automatically discharged on completion of the trust.
- (f) **Death of trustees**

8.10 VESTING OF PROPERTY IN TRUSTEES

The settlor must transfer the property to the original trustees in the proper legal manner. Similar transfers must be made on a change of trustee; but if a new trustee is appointed **by deed**, this operates to vest property **automatically**, except for:

1. Land conveyed by way of mortgage to secure trust moneys lent;
2. Leasehold land held under a covenant not to assign without consent (unless consent is obtained); and
3. Registered stocks and shares, which must be transferred in the proper manner S.41.

The court has power to make vesting orders in appropriate circumstances.

8.11 POWERS AND DUTIES OF TRUSTEES

Powers and duties may be imposed or conferred on trustees either:

1. By the trust instrument, or
2. By the general law.

Duties impose an **obligation** upon the trustees to act;

powers give them a **discretion**, which they can only exercise if they are **unanimous (re Hilton)**

A power may be coupled with a duty, in which case the trustees must act, but have a discretion as to the manner of acting (e.g in relation to investment of trust funds).

8.12 POWERS OF INVESTMENT

The trustees have a duty to obtain control of trust assets and to invest trust funds in **authorised** securities.

The trustees may invest in such securities as are authorised in the trust instrument or by the Trustee Act. In any case, they must have regard to -

1. The need for appropriate diversification; and
2. The suitability of the proposed investments to the trust.

(a) Investments under the Trustee Act

The act defines the categories of investment as follows:

1. **Fixed interest** securities are:
 - i. Securities which under their terms of issue, bear a fixed rate of interest; or
 - ii. Mortgages of immovable property; or

-
- iii. Deposits, whether fixed-term or otherwise, with a bank or financial institution building society or the Kenya Post Office Savings Bank.
2. **“Wider Range “**, i.e. building society shares, units of authorised unit trusts, and stocks and shares issued by Kenyan companies if:
- i. Company has issued and paid up capital of at least Shs.10 million.
 - ii. Dividends have been paid on the shares in each of the preceding five years; and
 - iii. The shares are quoted on the Nairobi Stock Exchange.

In addition, immovable property in Kenya for an estate in fee simple or for a term of years of which not less than 40 years is unexpired

3. Special-range property - property represented by any power of investment exercisable by a special investment clause contained in the trust instrument e.g. power to invest in the shares of a private company. This property must be placed in a separate part of the fund and the provisions for division of the fund into “narrower” and the “wider” range parts will only apply to the residue of the fund. If special range property is realised and converted into property other than special range property e.g. sale precedes, the balance between “fixed interest” and “wider range property must be maintained.

Note

1. No investment can be made in “wider range”.
2. No more than 50% of trust funds to be invested in “wider range”.
3. No investment can be made in “wider range” securities unless “proper advice” has been obtained and considered i.e. written advice of a person reasonably believed by the trustees to be qualified by his ability in and practical experience of financial matters.
4. Additions to the fund, such as bonus shares, arising from an investment already held in one part of the fund will accrue to that part of the fund which contains the investment; in other cases an addition to the fund must be divided equally between the “fixed interest” and “wider” range parts, or compensating transfer must be made.
5. Property can only be transferred from “fixed interest” to “narrower” range or vice versa if a compensating transfer is made at the same time.
6. Withdrawals from the trust fund e.g. to pay a beneficiary – the trustees have discretion as to whether they sell “narrower” or “wider” range investments in order to meet the debt; consequently the 50/50 balance may be upset.

(b) Other powers of investment

1. **Shares and debentures:** A trustee may:
 - i. Invest in bearer securities if these would otherwise be authorised;
 - ii. Acquiesce in an amalgamation or reconstruction; and
 - iii. Take up or assign “rights” issues.
2. Not more than one-eighth of the value of trust fund or Shs.10,000, whichever is the greater, shall be invested in the securities of any one company or unit trust.
3. **Mortgages:** These are authorised under the Trustee Act if given in respect of **freehold** land or **leasehold** land with at least 40 years unexpired; the trustee may lend up to two-thirds the value of the land as assessed by a competent surveyor or valuer.
4. **Retention of securities:** A trustee is not liable **simply** for retaining an investment which has ceased to be authorised; but he must review periodically – with advice – wider range.

8.13 DELEGATION

A trustee cannot deleet unless:

1. It is necessary or in the ordinary course of administration; or
2. Authorised by the trust instrument; or
3. Authorised by statue: the statutory powers of delegation are:
 - i. He may employ and pay an agent, e.g. a solicitor, banker ore or stockbroker to do any necessary act without liability for the agent's default if he was employed in good faith;
 - ii. He can, by means of a power of attorney, delegate the exercise of all or part of his trust for up to 12 months. He may not delegate to a sole co-trustee unless it is a trust corporation. The power of attorney must be witnessed by at least one person. Notice of the delegation must be g iven within 7 days to co-trustees and persons with power to appoint new trustees. The must musts specify the date of commencement, duration, the delegate, reason for delegation, and, if delegation is partial, which part of the trust is delegated. The trustee remains personally liable.
 - iii. He may appoint a competent and independent surveyor or valuer to value property mortgaged as security for trust money lent, and is not liable if he lends more than two-thirds of the valuation and the valuer's or surveyor's report advised the loan;
 - iv. Trustees for sale of land my delegate powers of leasing and management to the person entitled to possession, being of full age, without liability for his acts or defaults.

8.14 MAINTENANCE

Trustees may pay to the parent or guardian out of income of a fund held on the trust for an infacnt reasonable sums for his maintenance and education, having regard to his age and station in life, subject to the following conditions:

1. The power is subject to any prior interest or charge affecting the property;
2. A payment must be in proportion to amounts paid from other available funds (if any);
3. The power is not affected by the existence of a person bound by law to maintain or educate the infant; nor is it affected by the fact that particular sums have already been set aside for this purpose;
4. The power exists whether the infant's interest is vested or contingent (provided, in the latter case, that the trust carriers the intermediate income);
5. Payments out of capital may be valid, but should normally only be made under S.34 (see below) or with the consent of the court;
6. The residue of the income must be accumulated and invested;
7. The trust instrument may exclude this power.

8.15 ADVANCEMENT

Trustees may apply **not more than half of the presumptive or vested share of the capital held in trust for any person** (infant or adult) for his advancement or benefit (including maintenance) on the following conditions:

1. The trust property consists of money or securities or property held on trust for sale;
2. No advance can be made to **prejudice any person with a prior interest**, unless that person is of **full age and gives his written consent**;
3. The **interest may be vested or contingent**;
4. The advance must be brought into account on his becoming absolutely entitled;
5. The **power may be excluded** by the trusts instrument S .34.

8.16 INSURANCE

Trustees may insure trust property against loss or damage by fire subject to the following conditions:

1. The insurance must not exceed the full value of the property;
2. The trustees must not insure if:
 - i. The trust instrument forbids this, or
 - ii. The trustees are bound to convey the property absolutely to the beneficiary on request;
3. Premiums may be paid out of income of the trust property (not necessarily the property insured);
4. Insurance money received is to be treated as capital, and held on the same trusts as the property insured.

8.17 PROTECTION AGAINST CLAIMS

The trustees may protect themselves against claims after discharge in the following ways:

1. As regards liability for rent and other obligations under a lease or rent charge, **they may pay all outstanding liabilities and make provision for fixed and ascertained future claims**, and may then distribute the property to a beneficiary or purchaser entitled thereto without any further provision S.28.
 2. Before conveying or distributing the trust property they may **advertise for claims** in the **Gazette and a local paper requiring** interested parties to send in particulars of their claim within a stated time, **being not less than 2 months**, and are not liable after the time limited in the advertisements to persons of whose claims they have no notice; but they must make **all proper searches and enquiries S.29**.
 3. They may pay **into court monies or securities remaining in their hands, and** the receipt of the appropriate officer of the court operates as a good discharge S.63.

8.18 DEPOSIT OF DOCUMENTS

Trust documents may be deposited for safe custody with a banker or company whose business includes the taking of documents for safe custody, and the costs thereof paid out of income S.22.

8.19 SETTLEMENT OF LIABILITIES

Wide powers of compromise are granted to trustees by the **Trustee Act**. Two or more trustees or a sole trustee, where authorised, may:

1. Pay or allow any claim on any evidence they think sufficient;
2. Accept a composition or a security, real or personal, for any claim;
3. Allow any time for payment of a debt;
4. Compromise, compound, abandon, submit to arbitration, or otherwise settle a claim.

For these purposes they may enter into any agreement or arrangement, or do any other thing as seems expedient, without liability for any loss incurred while acting in good faith S.16.

8.20 DUTIES OF TRUSTEES

(a) Not to profit from the trust

A trustee may not receive **remuneration** except:

1. By **order of the court**, if the trust is very onerous or the services of the trustee very valuable;
2. Under authority in the **trust instrument**;
3. By consent of **all the beneficiaries**, being all **sui juris** and absolutely entitled;

4. In the case of the Public Trustee, whose fees are fixed by the Treasury; moreover, where the court appoints a corporation to be a trustee, the corporation may charge such remuneration as the court authorises;
5. In the case of an advocate-trustee who may charge his costs unless acting alone; moreover the partner of an advocate-trustee may be employed by him on trust work and be paid his charges, so long as the partner alone is entitled to any profit;
6. If the trust property is situated **abroad** and the **foreign law** permits payment.

Trustees have, however, a right to be **indemnified**:

1. **Out of trust property, for all expenses properly** incurred in the execution of the trust e.g. insurance premium paid S.32(2);
2. **Against a beneficiary if -**
 - i. The trustee accepted the trust at the **request of the beneficiary** and the **beneficiary is the settlor; or**
 - ii. The **beneficiary is the sole beneficiary, sui juris, and absolutely entitled;**
 - iii. The expense was incurred at the request of **all beneficiaries, being sui juris and absolutely entitled.**
3. For the cost of litigation brought or defended with leave of the court or otherwise properly for the benefit of the estate - the indemnity here comes out of the trust estate.

(b) **To keep and audit accounts**

Trustees **must** keep accounts and produce them to any beneficiary together with all reasonable information as to the financial position of the trust.

The trustee **may** have the accounts audited by an independent accountant, but not more than once every **three years**, unless the nature of the trust makes more frequent audits reasonable S.23.

(c) **To observe terms of trust**

Trustees must comply with the trust instrument and the rules of equity; they need not consult the beneficiaries or take instructions from them; but they may not depart from the terms of the trust unless authorised by the court, either:

1. Where a particular transaction is expedient for the trust as a whole, but the trustees have no power to effect it S.56; or
2. Under the Trustee Act, which empowers the Court to sanction any agreement for varying or revoking all or any of the trusts, or enlarging the management and administration powers of trustees on behalf of beneficiaries who are, as yet, unascertained or who are under a disability such as infancy.

8.21 BREACH OF TRUST

(a) **Remedies available to beneficiary**

1. **Injunction** - to prevent unauthorised action by trustees;
2. **Personal action** - a trustee is only liable for his own acts and defaults, and not for those of an agent or co-trustee unless these take place with his knowledge or by reason of his own "wilful defaults" (re Munton).

If a trustee commits a breach of trust he must -

- i. Make good any capital loss, with interest at 4% or 5% if he has used the money for his own purposes or been guilty of fraud, and
 - ii. Account for any profit he has made.
3. **Criminal liability** for fraudulently converting trust property.

(b) **Defence of trustee**

1. He may be relieved from liability if, in the opinion of the court, he acted **honestly and reasonably** and ought to be excused;
2. He may also be released by **any beneficiary, being sui juris** and with knowledge of the facts, from liability to **that beneficiary only**;
3. **Lapse of time**: an action for breach of trust is statute-barred **after six years** except when a beneficiary under a disability, such as infancy, when time does not begin to run until the disability ceases: moreover there is no limitation periods where:
 - i. **Trustee was fraudulent**; or
 - ii. To recover from the trustee trust property or the proceeds thereof **in his possession or previously received by him and converted to his own use**.

(c) **Contribution and indemnity**

Generally the trustees are jointly and severally liable to the beneficiaries and a trustee sued may claim **contribution** from the others where although two or more trustees are liable, one has paid more than his fair share of the loss; or a complete **indemnity** against -

1. A trustee who actually committed and obtained the benefit of the breach; or
2. An advocate trustee who advised the breach; or
3. A trustee who is also a beneficiary, to the extent of his beneficial interest.

(d) **Tracing trust property**

Apart from suing the trustee, in the event of a breach of trust, the beneficiary may follow the trust property and recover it from third parties, or the proceeds thereof from the trustee. But he cannot follow property which has ceased to be identifiable, or which has passed into the hands of a person taking for value without notice of his interest. Some rules of tracing:

1. Where the trustee mixes the funds of two separate trusts in one bank account, the presumption is that the first trust money paid into the account is the first drawn out, the Rule in Clayton's Case;
2. Where a trustee mixes trust funds with his own in a single bank account and draws upon that account for his own purpose, the presumption is that he has drawn on his own money first even if it was paid in more recently than the trust money - (re Hallett's Estate);
3. Where a trustee mixes trust funds with his own, the beneficiaries will have a first charge on the mixed fund for the trust money;
4. Where a trustee purchases property with his own money and with trust money, the beneficiaries will have a first charge on the property purchased.

8.22 TRUST ACCOUNTS

(a) **Object of trust accounts**

1. To demonstrate that the trust funds have been applied in accordance with the trust instrument;
2. To give details of transactions to trustees, beneficiaries and other interested parties.

(b) **Accountability**

The accounts of a trust should include **all** the property of the trust whether or not in the hands of the trustees. For example, interests in expectancy and foreign property may not be under the trustees' control but should still be shown.

(c) **Income and capital**

In many trusts different persons are entitled to the income and the capital and this necessitates a careful distinction between the two.

(d) **Form of the accounts**

The accounts should be as simple as possible for the benefit of trustees and beneficiaries who are not trained in accounting.

Trust accounts and supporting books and vouchers should be kept for a longer period than would be the case with commercial documents.

(e) **History of trust**

The following general information should be kept with the trust documents:

1. Summary of will or trust deed;
2. Short history of the trust;
3. Trustees' names and addresses;
4. Names and addresses of beneficiaries (present and future) together with dates of birth, marriage and death and relationship to settlor.

(f) **Accounting Date**

In determining the accounting date of the trust, the trustees will consider the following:

1. Date of death (accounts to anniversary of death);
2. Fiscal year-end (accounts to 31st December);
3. Due date for payment of annuities;
4. Beneficiaries' income requirements.

(g) **Content of accounts**

Periodical accounts should normally consist of:

1. Statement of financial position of the whole trust;
2. Capital account;
3. Income account;
4. Schedules and subsidiary accounts explaining, where appropriate, items 1 to 3 above.

8.23 STATEMENT OF FINANCIAL POSITION(a) **Grouping of items**

Items in the Statement of financial position should be grouped under appropriate headings. In particular, a trust operating the provisions of the **Trustee Act** will have headings for:

1. The fixed interest securities and fund;
2. The wider range securities and fund;
3. The special range securities and fund.

The Statement of financial position will also clearly distinguish between items representing income and those representing capital.

(b) **Comparative figures**

Comparative figures should be shown where relevant.

(c) **Capital account**

Where the **Trustee Act** has been applied, the capital account will be divided between the fixed interest,

wider and special ranges. The balance on the capital account shows the total book value of the capital funds.

(d) **Liabilities**

Careful distinction should be made between liabilities on capital account and those on income account.

(e) **Assets**

1. **The classification of investments** in the Statement of financial position will be under a few broad headings with schedules listing the individual assets. Where the **Trustees Act** has been applied all investments must be clearly allocated to their appropriate fund;
2. **Unauthorised investments** held under a power of postponement should be separately shown;
3. **The book value of investments** will be as follows:
 - i. Devolving on trustees as part of deceased's estate - PROBATE VALUE;
 - ii. Part of a gift by a living settlor - MARKET VALUE at date of gift;
 - iii. Purchased by trustees - COST
4. **Revaluation of investments** will normally take place in the following circumstances;
 - i. Where trustees decide to apply provisions of **Trustee Act**;
 - ii. Distribution to a beneficiary under the trust instrument.
5. **Cash and bank balances** should be distinguished between income and capital.

8.24 INCOME ACCOUNT

(a) **Classification**

Income will be classified under appropriate headings:

1. Rents;
2. Interest on Government securities;
3. Dividends;
4. Interest on mortgages.

(b) **Taxation**

Income should be stated gross i.e. before tax has been charged on it. Provision for the total liability to tax should be shown as a charge against total income. When income is received net of withholding tax, for accounting purposes the income is grossed by and tax is shown as a pre-payment.

(c) **Accruals**

It is a golden rule that income is NOT provided for until received but expenditure is accrued. In the USA, both income and expenditure are accrued in accordance with Generally Accepted Accounting Principles. In the UK, expenditure is accrued in accordance with the accruals concept, but income is recorded only when it is received. In Kenya, the Explanatory Forward to Kenyan Accounting Standards states that Kenyan Accounting Standards are intended for application to all financial statements issued by estates and trusts; the accrual assumption is recognised in Kenya Accounting Standard Number 1 as one of the fundamental accounting assumptions; hence, in Kenya, income should be accrued to the Statement of financial position date.

(d) **Statutory apportionments**

Investments should be maintained at their probate value and where an apportionment to capital has been made, a transfer should be made to the estate capital account to restore the investment to probate value.

8.25 ACCOUNTS UNDER TRUSTEE

(a) **Authorised investments**

The investments which trustees are permitted to hold may be specifically stated in the will or deed constituting the settlement.

Where the will or deed is silent on the matter, the authorised investments are as provided by statute.

The Trustee lays down the scope for trustees' investments but has also introduced safeguards to prevent excessive losses to trust funds from unsuitable investments.

(b) Division of the trust

The safeguards consist in the division of the trust funds into portions. Before this division takes place, the investments are revalued in order to determine the total value of the funds as at the date of division.

Any investments which are acquired or retained under a **specific power** in the will or settlement are designated as **special range** property and are kept quite separate from the other investments. The remainder of the property is to be divided into two equal parts, the fixed interest and the **wider range**.

The fixed interest part of the trust **must** contain fixed interest securities **only**.

The **wider range** part of the fund **may** contain either fixed interest or wider-range investments.

When special range property is realised, the proceeds must be invested equally in fixed interest and wider-range securities.

(c) Fixed Interest Securities - no advice in writing is required before an investment in fixed interest securities is made.

1. Kenya Government Securities.
2. Treasury Bills.
3. Fixed interest securities guaranteed by the Kenya Government.
4. Fixed interest securities quoted on the Nairobi Stock Exchange issued by a company incorporated in Kenya which has a paid-up capital of not less than Shs10m and which has paid a dividend in each of the preceding 5 years.
5. Fixed interest securities issued by Kenya Railways or the Industrial Development Bank.
6. Local Authority loans.
7. A deposit, whether fixed term or otherwise, with a bank or financial institution, building society or the Kenya Post Office Savings Bank.
8. Mortgages of freehold property or leasehold property having not less than 40 years unexpired.

(d) Wider-range Investments

(requiring advice in writing from a properly qualified person)

1. Quoted shares of a Kenya company with a paid-up capital of not less than Shs10m and has paid dividends on all issued capital for the past five years.
2. Shares in approved building societies.
3. Units issued by authorised unit trusts.

(e) Dealing with changes in the trust

1. **Profits or losses on disposal of investments** should be treated as belonging to that part of the fund out of which they accrued.

If not applicable to either part, the accrual must be divided between each fund.

2. **Compensating entries** must be made to restore the original status quo if the proceeds of fixed interest investments are re-invested in wider-range investments or vice versa.
3. **Property taken out of trust** may be taken from either part, without any necessity for compensating entries.
4. **IT SHOULD BE NOTED THAT THE ONLY TIME AT WHICH THE NARROWER AND WIDER RANGE PARTS WILL NECESSARILY BE EQUAL IS WHEN THE FUNDS ARE FIRST DIVIDED INTO TWO HALVES.**

(f) Pro-forma accounts under Trustee Act

I. PRO-FORMA STATEMENT OF FINANCIAL POSITION

		Shs'000
Fixed Interest investments		
(detailed)	2,120	
Cash at bank	<u>900</u>	3,020
Wider range investments		
(detailed)	5,450	
Cash at bank	<u>550</u>	6,000
Special range investments		
(detailed)		500
Cash at bank		
(income)		<u>30</u>
		<u>9,550</u>
Estate Capital account		
Fixed interest range	3,020	
Wider range	6,000	
Special range	<u>500</u>	9,520
Estate Income account		
		<u>30</u>
		<u>9,550</u>

II. PRO-FORMA ESTATE CAPITAL ACCOUNT

	Fixed Interest Shs'000	Wider Shs'000	Special Shs'000		Fixed Interest Shs'000	Wider Shs'000	Special Shs'000
Contra (transfer of Special Range realisation proceeds equally to fixed interest and Wider Range)			700	Bal b/f	4,800	5,300	1,100
Investment Account (loss on disposal of fixed Interest Range Investments)	40			Investment Account (profit on disposal of Special Range investments)			100
Distribution Account Accounts (distribution of proceeds of realisation Fixed Interest Investments to person absolutely entitled)	2,380			Contra (transfer of Special Range realisation proceeds equally to Fixed Interest and Wider Range	350	350	
Bal.c/d	<u>3,020</u>	<u>6,000</u>	<u>500</u>	Investment Accounts (revaluation of investments in order to ascertain share attribute to beneficiary absolutely entitled)	<u>290</u>	<u>350</u>	
	<u>5,440</u>	<u>6,000</u>	<u>1,200</u>		<u>5,440</u>	<u>6,000</u>	<u>1,200</u>
				Bal.b/d	3,020	6,000	500

III. PRO-FORMA ESTATE CASH BOOK

	Fixed Interest	Wider	Income	Fixed Interest	Wider	Income
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
Balance b/f	100	200	50			
Investment a/c (realisation of Special Range Investments to be re-invested equally in Fixed Interest and Wider Range)	350	350				
Investment a/c (income received on Fixed Interest and Wider Range Investments)			600			
Investment a/c (disposal of Fixed Interest investment)	<u>2,020</u> <u>2,470</u>	<u>—</u> <u>550</u>	<u>—</u> <u>650</u>			
Bal.b/d	90	550	30			
				Estate Income a/c (payment on account to life tenants)		620
				Distribution a/c (payment of capital due to beneficiary absolutely entitled)	2,380	
				Bal.c/d	90	550
						30
					<u>2,470</u>	<u>650</u>

8.26 ACCUMULATION ACCOUNTS FOR MINORS

(a) Income accumulations

When property is left in trust for minors, the income earned for the period will be divided equally or according to the terms of the will or trust deed. These shares of income will be credited to the accounts of the infant beneficiaries, usually called Income Accumulation Accounts.

(b) Maintenance payments

Any amounts paid for maintenance (either by the terms of the will or trust deed or under **S.33 of the Trustee Act**) will be debited to the respective Income Accumulations Accounts.

(c) Investment of accumulated income

The income accumulations must be invested from time to time and the investments earmarked as being

on Accumulations Account.

The income arising on accumulation investments should be credited to Income Accumulations Account and divided between the infants in proportion to the balances on Accumulations Account at the commencement of the year.

It will be appreciated from the above that the Income Accumulations Account is merely an income account ruled with columns to distinguish the income belonging to each beneficiary. The total balances on this account will be represented by Accumulation Investments and cash at bank.

(d) Distribution to a beneficiary

Before distribution to a beneficiary, the investments will be re-valued and the profits or losses divided between the beneficiaries as follows:-

- i. **Capital investments**, equally, or according to the terms of the will or trust deed;
- ii. **Accumulation investments**, according to the balances on the Income

Accumulations Account at the commencement of the year.

A beneficiary may be paid out the share due to him in one of the following ways:-

- i. Exact division of each investment,
- ii. Appropriation **in specie** by agreement and adjusting either way in cash,
- iii. All investments realised and the amount due to the beneficiary paid to him.

(e) Pro-forma accounts

Accumulation trust with three beneficiaries A,B & C, entitled equally

1. PRO-FORMA ESTATE CAPITAL ACCOUNT

	A	B	C		A	B	C
	Shs'000	Shs'000	Shs'000		Shs'000	Shs'000	Shs'000
Distribution a/c (transfer of amount due to beneficiary A on attaining his majority)	2,200			Bal.b/f Investment Accounts (profit on revaluation credited to beneficiaries in proportions directed in will or trust deed)	2,000	2,000	2,000
Bal.c/f	<u>—</u> <u>2,200</u>	<u>2,200</u> <u>2,200</u>	<u>2,200</u> <u>2,200</u>		<u>200</u> <u>2,200</u>	<u>200</u> <u>2,200</u>	<u>200</u> <u>2,200</u>

PRO-FORMA INCOME ACCUMULATIONS ACCOUNT

	A	B	C		A	B	C
	Shs'000	Shs'000	Shs'000		Shs'000	Shs'000	Shs'000
Cash (maintenance payments)	40	30	15	Bal.b/f	100	100	50
Distribution a/c (balance due to A)	190			Investments on Capital a/c (income received on capital investments divided in proportion prescribed in will or trust deed)			
				Shs.300,000	100	100	100
Bal.c/f	-	200	150	Investments on accumulations a/c (income received on accumulations investments in proportion to balance on Income Accumulations Account at beginning of year)			
				Shs.25,000	10	10	5
				Investments on Accumulations Account (profit on realisation and revaluation of accumulation investments in proportion to balance on income Accumulations Account at beginning of year)			
				Shs50,000	20	20	10
	<u>230</u>	<u>230</u>	<u>165</u>		<u>230</u>	<u>230</u>	<u>165</u>

3. PRO-FORMA DISTRIBUTION ACCOUNT

Shs'000	Shs'000
Investment A/cs (investments transferred to beneficiary at re-valuation figures)	
2,200	
Cash (balance due to beneficiary)	
190	
<u>2,390</u>	
	Estate Capital a/c (balance due to beneficiary on capital account)
	2,200
	Income Accumulation Account (balance due to beneficiary on accumulations a/c)
	190
	<u>2,390</u>

4. PRO-FORMA STATEMENT OF FINANCIAL POSITION

	Shs'000	Shs'000
Investments on Capital Account (detailed)		4,400
Investments and Cash on Accumulation Account (detailed)		<u>350</u> 4,750
Estate Capital Account		4,400
Income Accumulation accounts		
B	200	
C	<u>150</u>	<u>350</u> 4,750

Example

When both parents of Alice and Beatrice died in a car accident, their rich uncle set up a trust to provide for them until they married. They were to share income equally. When Alice and Beatrice married the capital was to pass equally to the children of his nephews and nieces.

The uncle directed the trustees to invest only in investments authorised by the Trustees Act (Cap.167 of the Laws of Kenya) except:

1. they could retain at their absolute discretion 10,000 shares of Sh.10 each in Updown Limited, a private company;

2. they would not recall a loan of Sh.1,200,000 to Alice, unless Alice wished to repay the whole or part of it; the loan was secured by a mortgage on Alice's leasehold house of which 15 years remain unexpired. After the trust had been in existence for 2 years, the statement of financial position at 31 March 1996 was as follows:

	Sh. '000'	Sh. '000'
Fixed interest investments		
Sh.3 million 12% Kenya stock at cost		2,955
Cash at bank		<u>45</u>
		3,000
Water range investments:		
30,000 shares in BAT (K) Ltd.		3,000
Special range investments:		
15% mortgage loan to Alice	1,200	
10,000 shares of Sh.10 in Updown Ltd.	<u>150</u>	1,300
Income cash		<u>72</u>
		<u>7,422</u>
Trust capital:		
Fixed Interest Fund	3,000	
Wide Range Fund	3,000	
Special Range Fund	1,350	7,350
Life Tenants' Accounts		
Alice	36	
Beatrice	36	72
		<u>7,422</u>

Interest on the Kenya Stock was received on 30 June 1996 and 31 December 1996. The interest on the mortgage loan to Alice was due on 31 March each year. She had paid interest due on 31 March 1996, but negotiated with the trustees that she would not draw out any income from the trust in respect of the year 31 March 1997. Instead her share of the income would be used to pay the interest on the loan and to pay any repairs relating to the house; any balance remaining would be used to pay part of the loan.

The trust's other receipts and payments were as follows:

	Sh. '000'
1996	
April 15	Amount paid to life tenants 72
April 30	Dividend of 60% on the share of Updown Ltd. for the year ended 31 December 1995
May 28	Amount paid for repair for Alice's house 24
June 29	Proceeds of sale of 30,000 shares in BAT (K) Ltd. 3,600
July 5	Purchase of 36,000 Sh.10 ordinary shares in Nation (Kenya) Ltd. a wider range investment. 3,600
September 15	Receipt of interim dividend of 30% on the shares in Nation (K) Ltd., for the year to 31 December 1996.
December 14	Receipt of proceeds of sale 10,000 shares in Updown Ltd. 360
December 31	Purchase of Sh. 450,000 nominal of 12% Kenya Stock at 90

1997

January 20	Paid to Beatrice in respect of income	150
March 31	Paid out of income administration expenses for the year	60

Required

- (a) Write up the trust cash account, the income account, the life tenants' account and the trust capital account for the year ended 31 March 1997. (12 marks)
- (b) Prepare the trust statement of financial position as at 31 March 1997. (8 marks)

(Total: 20 marks)**Solution****TRUST INCOME ACCOUNT**

1996	Sh.'000'	1996	Sh.'000'
		April 30 Cash book	
		Dividend from up down	60
		June 30 Cash book	
		12% Kenya stock interest	180
		15 Sept Cash book	
		Dividend from nation	108
		Dec 31 Cash book	
		12% Kenya stock Interest	180
1997		1997	
Mar 31 Cash book – Expenses	60	March 31 Life tenant	
Mar 31 Life tenants:		Interest on loan to Alice	180
Income division (A)	324		
(B)	<u>324</u>		
	<u>708</u>		<u>708</u>

LIFE TENANT ACCOUNT

1996		Alice	Beatrice		Alice Sh.'m'	Beatrice Sh.'m'
April 15	CB: Maintenance	36	26	1996	36	36
May 28	Cash Book – repaid	24		April 1 Bal b/d		
1997						
Jan 20	CB Maintenance	-	150	1997		
Mar 31	Mortgage Int (Income	180		Mar 31 Income A/c		
Mar 31	A/c)	120		Division of	<u>324</u>	<u>324</u>
Mar 31	Mortgage A/c	—	<u>176</u>	income		
	Bal c/d					
		<u>360</u>	<u>360</u>		<u>360</u>	<u>360</u>

TRUST CASH BOOK

	Income	Special range	Wide Range	Fixed interest		Income	Special range	Wide Range	Fixed interest
1996					1996				
Apr 1 Bal b/d	72				Apr 15 Tenants	72	-		-
Apr 30 Income A/c	60				May 28 Tenants	24			
Jul 29 BAT Investment			3,600		Jul 5 Investment in Nation Central		360	3,600	
Jun 30 Income Int.	180				Dec 31 Inv. In 12% K Stock			180	225
Dec 14 Inv in Updown		360	180	180					
Sep 15 Nation	108								
Dec 31 Investment in 12%	180								
1997					1997				
Mar 31 Central	-	-	60	60	Jan 20 Tenant	150			
					Mar 13 Income a/c	60			
					Mar 31 Central	120			
					Mar 31 Bal c/d	<u>124</u>		<u>60</u>	
	600	360	3,840	225		600	360	3,840	225

TRUST CAPITAL A/C

	SR	F1	WR		SR	F1	WR
Dec 14 Contra	360			1996			
Mar 31 Contra	120			Apr 1 Bal c/d	1,350	3,000	3,000
				Jun 29 Invest. In BAT			600
Mar 31 Bal c/d	1,080	3,240	3,840	Dec 14 Invest in updown Contra	210	180	180
				1997			
				Mar 31 Contra		60	60
	1,560	3,240	3,840		1,560	3,240	3,840
				Bal b/d	1,080	3,240	3,840

WORKING

UPDOWN A/C

	Sh.'000'		Sh.'000'
B/F	150	C.B	360
Spearl range fund	<u>210</u>		
	<u>360</u>		<u>360</u>

MORTGAGE LOAN A/C

	Sh.'000'		Sh.'000'
Bal b/d	1,200	Life tenant	120
		Bal c/d	<u>1,080</u>
	<u>1,200</u>		<u>1,200</u>

B.A.T A/C

	Sh.'000'		Sh.'000'
Bal b/f	3,000	Cash book	3,600
Wide range fund	<u>600</u>		<u>3,600</u>
	<u>3,600</u>		<u>3,600</u>

ALICE AND BEATRICE

STATEMENT OF FINANCIAL POSITION AS AT 31 March 1997

	Sh.	Sh.
FIXED INTEREST INVESTMENTS		
3,250,000 (W) 12% Kenya stock	3,180	
Cash at bank	<u>60</u>	3,240
WIDER RANGE INVESTMENTS	3,600	
36,000 ordinary shares of Sh.10 in Nation	180	
200,000 (N) 12% Kenya stock	<u>60</u>	3,840
Cash at bank		
SPECIAL RANGE INVESTMENTS	1,080	1,080
15% mortgage loan to Alice		
INCOME ASSETS		<u>174</u>
Cash at bank		8,334
Trust Capital:		3,240
Fixed interest		3,840
Wider range		<u>1,080</u>
Special range		8,160
Life tenant account balance		<u>174</u>
		8,334

Example

Kahari and Ligaga two brothers are the life tenants of a trust set up by their rich uncle, Maundu. Maundu had never married. He set up the Maundu Trust with the following terms

The trustees were to have unrestricted powers of investment:

The trustees were to share any income that arose equally between Kahari and Ligaga.

Kahari and Ligaga were to receive income until their deaths, on the death of either of the life tenants; one half of the capital passes absolutely to Nzau, Maundu's youngest brother.

The statement of financial position of the trust was as follows on 30 September 1999

CAPITAL ASSETS:	SH. '000'
House in Milimani, Nairobi	5,400.00
Sh 9 million 12% Kenya Treasury stock	8,820.00
60,000 Sh.10 ordinary shares in Uchumi Limited	3,870.00
24,000 Sh.10 ordinary shares in Media Group Ltd.	2,040.00
Cash at bank:: Capital	1,410.00
Income	<u>120.00</u>

	21,660.00
Trust capital	21,540.00
Trust income	<u>120.00</u>
	21,660.00

In the year ended 30 September 2000, the following transactions took place:

Interest on the 12% Kenya Treasury Stock was received on the due dates, 31 December and 30 June.

The trustees sold Sh 3million 12% Kenya Treasury Stock on 1 November 1999 to enable them to purchase a further 50,000 Sh.10 ordinary shares in Uchumi Limited at Sh.69 per share. The 12% Kenya Treasury Stock was sold at a price of 88. The shares in Uchumi Limited were purchased on 1 December 1999.

Kahari died on 31 January 2000. He had been living in the house in Milimani, Nairobi, owned by the trust, paying rent of Sh.40, 000 per month, quarterly in arrears. He had paid 3 months' rent on 31 October 1999 but had not paid the rent due on 31 January 2000: This was to be offset against his claims on the Trust. The house remained empty from 1 February 2000 onwards.

On 31 January 2000 the market values of the assets in the Trust were as follows:

House in Milimani Nairobi	Sh.9, 600,000
12% Kenya Treasury Stock	Sh.90
Sh.10 ordinary shares in Uchumi Limited	Sh.75
Sh.10 ordinary shares in Media Group Ltd.	Sh.100

Dividends of Sh.7.50 per share on the ordinary shares in Media Group Limited in respect of the year ended 31 December 1999 were received on 30 April 2000. Dividends of Sh.6 per share on the ordinary shares in Uchumi Limited in respect of the year ended 31 March 2000 were received on 30 June 2000.

The Trustees paid to the executors of Kahari, the amount due to Kahari, on 1 September 2000. On the same day, they paid the income due to Ligaga and distributed to Nzau the house in Milimani, Nairobi, 39,000 Sh.10 ordinary shares in Uchumi Limited and the remainder in cash. On 1 September 2000, the values of the assets were the same as on 31 January 2000.

Required:

Cash book and the trust capital account for the year ended 30 September 2000. (7 marks)

Show how the available income will be divided between Kahari, Ligaga and Nzau. Apportionments should be made on the basis of months.

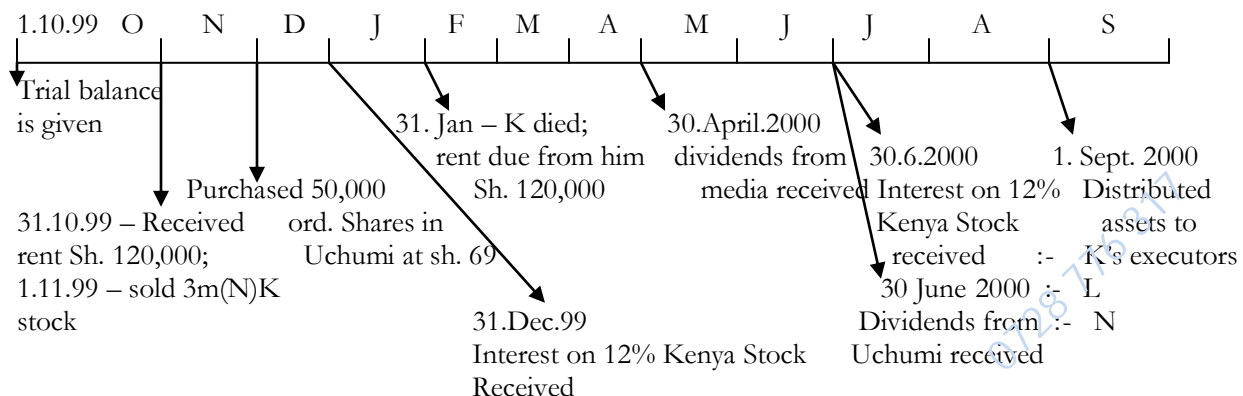
The distribution account for Nzau and the Trust Statement of financial position as at 30 September 2000.

The trustees incorporated revaluation into the books of the Trust. (7 marks)

(Total: 17 marks)

Solution

Since the trustees were to have unrestricted powers of investment, there is no need to split the fund into fixed interest or wider range or special range components.



The trust statement of financial position at the beginning of the year will be redrawn as follows:

	<u>Capital Fund</u>	<u>Income Fund</u>
	Shs. '000'	Shs. '000'
Milimani House	5,400	
Sh. 9m (N) 12% K Stock	8,820	
60,000 shares in Uchumi	3,870	
24,000 shares in media	2,040	
Cash at Bank	<u>1,410</u>	<u>120</u>
	<u>21,540</u>	<u>120</u>
Trust Capital/Income	<u>21,540</u>	<u>120</u>

Trust Cashbook

1999	Capital Sh. '000'	Income Sh. '000'	1999	Capital	Income Sh. '000'
Sh'000'					
1 Oct bal b/d	1,410	120	1 Dec in DSC (Uchumi)	3,450	
31 Oct Income: rent		120			
1 Nov Inv in Kenya T Stock	2,640				
31 Dec. Inv in Kenya T. Stock		360			
2000			2000		
31 April Inv. In media grp		180	1 Sept. Distribution a/c	600	78
30 June Inv in Kenya Stock		360	1 Sept. Life tenants	-	1,402
30 June Inv in Uchumi	<u>4,050</u>	<u>660</u>	1 Sept: Executors(K)	<u>4,050</u>	<u>320</u>
		<u>1800</u>			<u>1800</u>

Trust Capital

1999	Sh. '000'	1999	Sh. '000'
1 Nov Loss on disp.(12% Tstock)	300	1 Oct Bal b/d	21,540
2000		2000	
31 Jan Reval loss:		31 Jan Reval gain:	
12% Kenya T. Stock	480	Milimani house	4,200
		60000 Uchumi shares	630
31 Jan Distribution a/c (1/2)	13,125	50000 Uchumi shares	300
30 Sept. Bal c/d (1/2)	<u>13,125</u>	24000 Media shares	<u>360</u>
	<u>27,030</u>		<u>27,030</u>

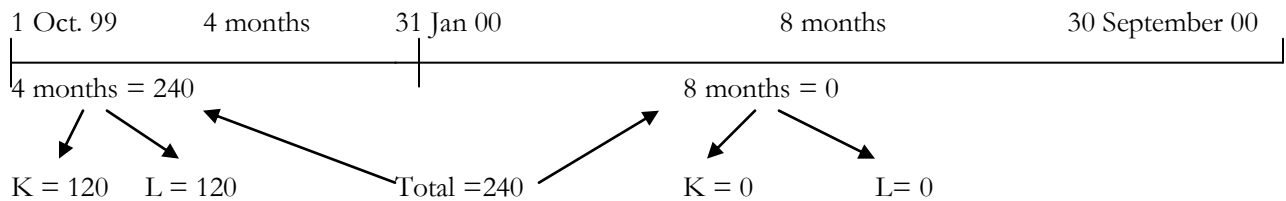
Workings for revaluation gains/losses

	Cost (Sh. '000')	Market price (Sh. '000')	
Gain/Loss(Sh.'000')			
Milimani House	5400	9600	4200G
60000 Uchumi shares	3870	4500	630 G
50000 Uchumi shares	3450	3750	300G
24000 Media shares	2040	2400	360G
Sh 9m (N) 12% Kenya Stock	5880	5400	(480)L

Income a/c

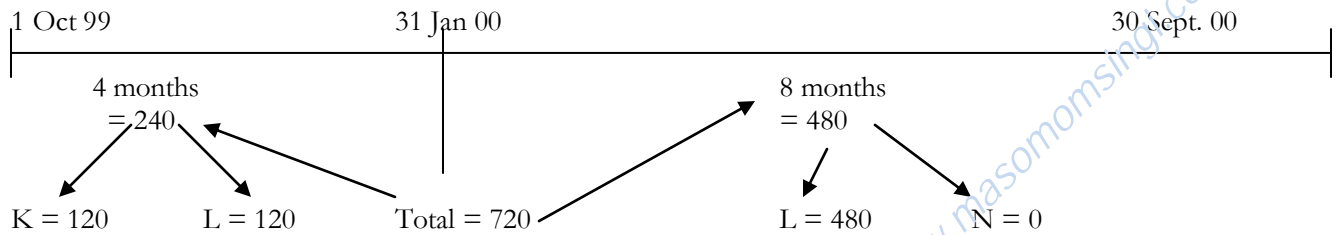
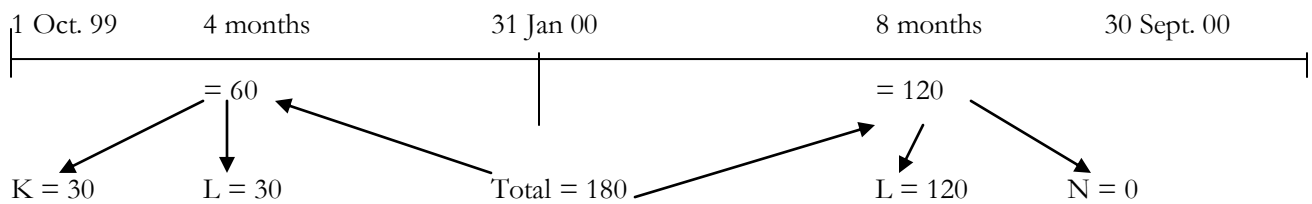
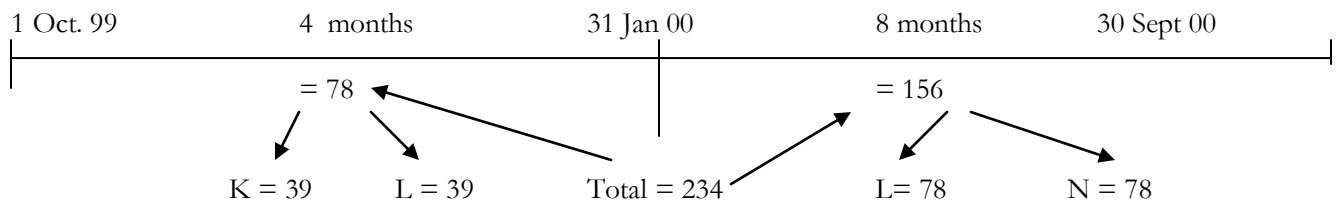
1999	Sh. '000'	1999	Sh. '000'
		1 Oct Bal b/d	120
		31 Oct. CB: Rent income	120
		31 Dec CB: Interest on K. Stock	360
2000		2000	
1 Sept. Life tenants: K	440	31 Jan Life tenants: Rent due	120
: L	1402	30 Apr Dividend from Media Grp	180
1 Sept. Distribution a/c: N	78	30 June Dividend from Uchumi	660
		30 June Int on 12% Kenya T Stock	<u>360</u>
	<u>1920</u>		<u>1920</u>

Rental Income:

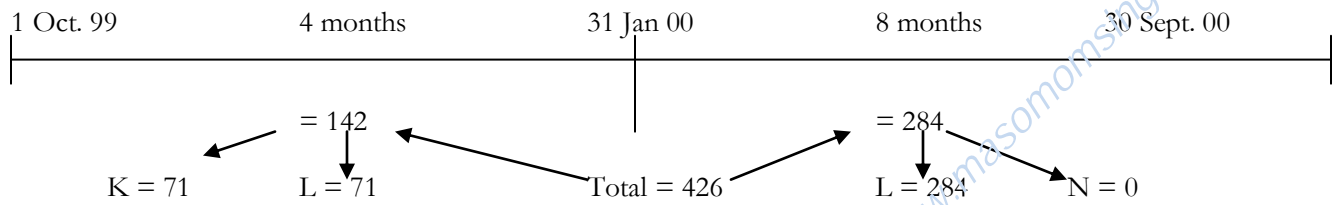


Distribution a/c

1999	Sh. '000'	1999	Sh. '000'
1 Sept: House in Milimani	9,600	31 Jan Trust capital	13,125
1 Sept: 39000 shares in Uchumi (at Sh. 75 per share)	2,925	1 Sept Trust Income	78
1 Sept: Capital cash	600		
1 Sept. income cash	<u>78</u>		
	<u>13,203</u>		<u>13,203</u>

Interest on 12% Kenya Stock**Media Group Dividend****Dividend from 39,000 shares in Uchumi**

Dividend from 71,000 shares in Uchumi



Summary of Income distribution

	Life tenants K	Life tenants L	Distribution a/c N
Balance b/d	60	60	-
Rental income	120	120	-
Interest on 12% K Stock	120	600	-
Media group dividend	30	150	-
Dividend on 39000 Uchumi shares	39	117	78
Dividend on 71000 Uchumi shares	<u>71</u>	<u>355</u>	-
	<u>440</u>	<u>1,402</u>	<u>78</u>

Life Tenants

2000	K:sh. '000'	L:Sh. '000'	2000	K:sh. '000'	L:Sh. '000'
31 Jan Income a/c: rent	120	-	1 Sept. Income a/c	440	1402
1 Sept. Cash book	-	1402			
1 Sept. Executor a/c	<u>320</u>				
	<u>440</u>	<u>1,402</u>		<u>440</u>	<u>1,402</u>

Executors (K) a/c

2000	Sh. '000'	2000	Sh. '000'
1 Sept. Cashbook	<u>320</u>	1 Sept. Life tenants	<u>320</u>

Ligaga:**Trust statement of financial position as at 30 Sept. 2000**

Capital investments:	Sh. '000'	Sh. '000'
71000 Uchumi shares @75	5,325	
24000 Media Group shares @100	2,400	
Shs. 9m (Nominal) 12% Kenya Stock	<u>5,400</u>	
		<u>13,125</u>
Trust capital a/c		<u>13,125</u>

Example

Kena, Limo and Mara had been orphaned when both their parents died in a bus accident in April 1992. Their uncle, Mr. Barua, a stockbroker on the Nairobi Stock Exchange, organised a harambee for them in June 1992 and raised Sh.1, 980,000. He invested this amount as follows:

	Sh.
9,600 Sh.10 Ordinary Shares in KAB Ltd.	432,000
12,600 Sh.10 Ordinary Shares in BBB Ltd.	756,000
13,200 Sh.10 Ordinary Shares in TEA Ltd.	<u>792,000</u>
	<u>1,980,000</u>

He established an accumulation and maintenance trust to hold these investments on behalf of the children. The trust had a wide investment clause. He ruled that accounts be made up to 31 May each year. When each child reached the age of 21, the trustees were to transfer to him his share of the fund at that date. Kena turned 21 years on 31 May 1996.

The balances on the Accumulation Accounts of Kena, Limo and Mara at 1 June 1995 were Sh.207, 900, Sh.103,950 and Sh.34,650. To this date, the trustees had used accumulated income to purchase 5,775 Sh.10 Ordinary Shares in TEA Ltd. On 1 June 1995, there was no cash in the income account in the bank.

In the year to 31 May 1996, Sh.222, 750 was received from Capital Investment and Sh.62,370 from Accumulation Investments and maintenance payments made on behalf of Kena, Limo and Mara were Sh.77, 000, Sh.81, 000 and Sh.94,000, respectively. On 31 May 1996, the market values of the shares in KAB Ltd., BBB Ltd and TEA Ltd, were Sh.60, Sh.80, and Sh.70 respectively.

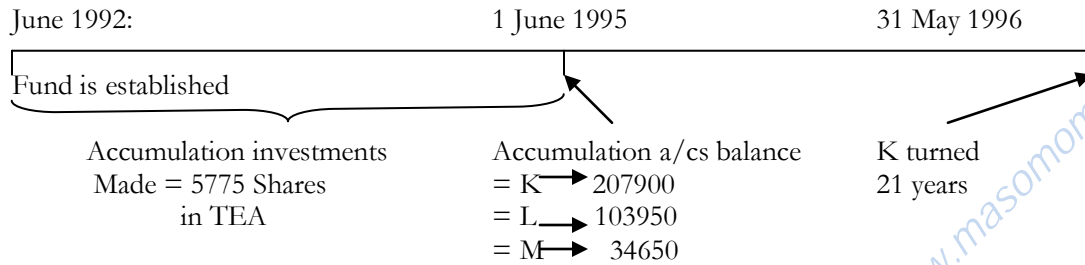
Kena was to receive 10,000 Sh.10 Ordinary Shares in BBB Ltd. and the balance due to him on capital would be made up of shares in KAB Ltd. Out of the accumulation assets, Kena was to receive Sh.32, 222 in cash and the balance in shares in TEA Ltd.

Required:

The beneficiaries' accumulation accounts for the year ended 31 May 1996 and distribution statements for the capital and accumulation assets as at 31 May 1996.

Solution

NB: The fact that the trust had a wide investment clause means there is no need to divide the fund into "fixed interest", "wider range" or "special range" sections.

**Distribution Statement: Capital Assets**

Total		Distribution To K		To remain in Trust	
Nominal/No	Value Shs.	Nominal/No	Value Shs.	Nominal/No	Value Shs.
Ordinary Shares in KAB 9,600	576,000	600	36,000	9,000	540,000
Ordinary shares in BBB 12,600	1,008,000	10,000	800,000	2,600	208,000
Shares in TEA 13,200	<u>924,000</u>	-	-	13,200	-
	<u>2,508,000</u>		<u>836,000</u>		<u>924,000</u>
					<u>1,672,000</u>

Distribution Statement: Accumulation assets

	Total		To K		To remain in trust	
	Nominal/No.	Value Shs.	Nominal/No.	Value Shs.	Nominal/No.	Value Shs.
Ordinary shares in TEA	5,775	404,250	3,500	245,000	2,275	159,250
Cash		<u>33,120</u>		<u>32,222</u>		<u>898</u>
		<u>437,370</u>		<u>277,222</u>		<u>160,148</u>

$$* (222750 + 62370 - 77000 - 81000 - 94000) = 33,120$$

Beneficiaries' Accumulation a/cs

	K(sh)	L(sh)	M(sh)		K(sh)	L(Sh)	M(sh)
Maintenance payment	77,000	81,000	94,000	Bal b/d	207,900	103,950	34,650
Distribution a/c	277,222			Income (Caps)	74,250	74,250	74,250
				Income (Acc)	37,422	18,711	6,237
Bal c/d	<u>-</u>	<u>133,236</u>	<u>26,912</u>	Reval gain (TEA)	<u>34,650</u>	<u>17,325</u>	<u>5,775</u>
	<u>354,222</u>	<u>214,236</u>	<u>120,912</u>		<u>354,222</u>	<u>214,236</u>	<u>120,912</u>

Trust Capital a/c

Distribution a/c	Shs. 836,000	Bal. b/d	Shs. 1,980,000
		Reval gain: (KAB)	144,000
		: (BBB)	252,000

Bal c/d	<u>1,672,000</u>	: (TEA)	<u>132,000</u>
	<u>2,508,000</u>		<u>2,508,000</u>

Trust Income a/c

	Shs.	Shs.		Shs.	Shs.
	Capital	Accumulation		Capital	Accumulation
Accum. a/c K	74250	37422	Investment a/c	222750	62370
L	74250	18711			
M	<u>74250</u>	<u>6237</u>			
	<u>222750</u>	<u>62370</u>		<u>222750</u>	<u>62370</u>

Trust Cashbook

	Shs.	Shs.		Shs.	Shs.
	Capital	Income		Capital	Income
Inv.a/c:Income	-	222,750	Accum a/c: Maint.	-	252,000
Inv a/c:Income		62,370	Distribution a/c	-	32,222
			Bal. c/d	-	898
	<u>-</u>	<u>285,120</u>		<u>-</u>	<u>285,120</u>

Example

Aviha died in 1997 and left, by his will, the residue of his estate to his children, Reuben and Levi, in equal shares. The will directed that a child's share of the estate should be ascertained and discharged on reaching twenty one years of age. The trustees were empowered to maintain the children out of the income and to use their unfettered discretion in the choice of investments.

The trial balance extracted from the books of the trust as at 31 July 2003 was as follows:

	Sh. "000"	Sh. "000"
Investment on estate capital account		
20,000 shares of Sh.100 each in ABC Ltd.	2,200	
30,000 shares of Sh.100 each in Mapingo Ltd.	2,800	
Investment on accumulation accounts:		
1,000 shares of Sh.100 each in ABC Ltd.	110	
1,000 shares of Sh.100 each in Mapingo Ltd.	90	
Bank balances:		
On estate capital account	200	
On accumulation accounts	50	
Estate capital account		5,200
Accumulation accounts:		
Reuben		150
Levi		<u>100</u>
	<u>5,450</u>	<u>5,450</u>

Reuben attained the age of twenty one years on 31 October 2003, on which date the market prices of the investments were

ABC Ltd shares

Sh. 125

Mapingo Ltd. Shares Sh. 100

Transactions in the three months to 31 October 2003 comprised:

- 1 August 2003: Receipt of dividend of sh. 5 each share in ABC Ltd.
- 31 August 2003: Maintenance payment of sh 30,000 and sh.20,000 for Reuben and Levi respectively.
- 31 October 2003: The trustees revalued all of the investments and discharged their liability to Reuben by the transfer to him of:
 - One half of each of the investments held on capital accounts
 - 3/5ths of each of the investments held on accumulation accounts.
 - Cash for the balance due to him.

Required:

- (i) Estate capital account.
- (ii) Accumulation accounts.
- (iii) Distribution to Reuben account.

(15 marks)

Solution

Trust Capital		Sh.'000'	Sh.'000'
Distribution (1/2)		2,850	Bal b/d 5,200
Bal c/d		<u>2,850</u>	Revaluation gains 500
		<u>5,700</u>	<u>5,700</u>

Workings for Revaluation Gains					
Capital	Initial MPS	Increased MPS	Increases Sh.	No. of shares	Gain Sh.'00'
	Sh.	Sh.		Sh.'000'	00'
ABC Ltd	110	125	15	20	300
Mapingo Ltd	93 1/3	100	6 2/3	30	200
Total					<u>500</u>
<u>Accumulation</u>					
ABC	110	125	15	1	15
Mapingo Ltd	90	100	10	1	10
	<u>191,434</u>	<u>191,434</u>		<u>237,046</u>	<u>237,0</u>
					<u>46</u>

(ii)

Accumulation A/c

	Reuben Sh.'000'	Levi Sh.'000'		Reuben Sh.'000'	Levi Sh.'000'
Maintenance	30	20	Bal b/d	150	100
Distribution	188	-	Dividend income(Capital)	50	50
Bal c/d	-	142	Dividend income (Accum) (3:2)	3	2
			Revaluation gain:		
			ABC: (3:2)	9	6
			Mapengo:(3:2)	6	4
	218	162		218	162

(iii)

Distribution A/c

	Sh.'000'		Sh.'000'
Capital investments:		Trust capital	2,850
10,000 ABC shares	1,250	Accumulation A/c	188
15,000 Mapingo shares	1,500		
Cash	100		
Accumulation investments			
600 Mapingo shares	60		
Cash	53		
	<u>3,028</u>		<u>3,038</u>

Cash A/c

	Sh.'000'		Sh.'000'
Bal b/d	200	Maintenance	50
Dividends (ABC) capital	100	Reuben distribution	100
Dividends (ABC)	5	Bal c/d	100
	<u>200</u>		<u>200</u>
	<u>105</u>		<u>105</u>

Statement of financial position as at 01.11.03

	Sh.'000'	Sh.'000'
Assets		
Capital investments:		
10,000 shares in ABC Ltd @Sh.125		1,250
15,000 shares in Mapingo Ltd @ Sh.100		<u>1,500</u>
		2,750
Accumulation Investment		
400 ABC shares @Sh.125	50	
400 Mapingo shares @ Sh.100	<u>40</u>	90
Cash: Capital	100	
Income	<u>52</u>	<u>152</u>
		<u>2,992</u>
Trust capital	2,850	
Accumulation a/c	<u>142</u>	<u>2,992</u>

Tutorial note: The last 2 accounts are not required by the examiner, they are illustrative.

Example

Kiura and Maina are life tenants of a trust set up by their uncle. The trustees have investment powers restricted to those contained in the Trustee Act (Chapter 167 of the Laws of Kenya) except they could hold at their absolute discretion 300,000 shares of Sh.10 each in Kilimanjaro Enterprises Limited, a horticultural exporting company run by the uncle..

On 31 March 2002, the statement of financial position of the trust was as follows:

		Sh.'000'	Sh.'000'
Fixed interest investment:	Sh.2 million 10% Kenya stock 2007 (cost)	2,000	
	Sh.2 million 9% Kenya stock 2006 (cost)	1,800	
	Cash at bank	<u>200</u>	
			4,000
Wider range investments:	40,000 shares of Sh.100 in E.A. Breweries Ltd (cost)		4,000
Special range investment:	300,000 shares in Kilimanjaro Enterprises Ltd. (cost)		<u>3,000</u>
			<u>11,000</u>
Trust capital			4,000
Fixed interest fund			4,000
Wider range fund			<u>3,000</u>
Special range fund			<u>11,000</u>

In the year to 31 March 2003, the following occurred:

2002

- 30 June Interest for the year ended 30 June 2002 was received on 10% Kenya stock. School fees for Kiura and Maina were paid immediately using the whole amount received.
- 30 September A final dividend of 75% for the year ended 30 June 2002 was received from E.A. Breweries Ltd. (payout rate 10%).
- 30 September The E.A. Breweries Ltd. shares were sold at Sh.110 each. At the same time, a satisfactory buyer was found for the 300,000 shares in Kilimanjaro Enterprises Limited – these shares were sold for Sh.15 each. Some high yielding 12% Kenya stock 2008 was available at par on this date. It was decided to use all the wide range cash available to purchase this stock and designate it a wider range investment.
- 31 December Interest was received for the year on the 9th Kenya stock and Sh.42,000 interest was received on the fixed interest cash at bank.

2003

- 28 February 61,250 Sh.10 ordinary shares in ICDI Limited were purchased for Sh.40 per share using the fixed interest cash and a suitable switch was made to ensure adherence to the requirements of the Trustee Act. The market value of the 12% Kenya stock on this date was still par.
- 31 March All remaining income cash was paid across to the life tenants, after trust administration expenses of Sh.120,000 were paid for the year.

Required:

- (a) Write up the trust cash account, the income account (showing payments to beneficiaries in this account) and the trust capital account for the year ended 31 March 2003. (9 marks)
- (b) Prepare the trust statement of financial position as at 31 March 2003. (6 marks)

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0728 776 317

Solution

(a)		Trust Cash Account									
2002		Income	F1	WR	SR	2002		Income	F1	WR	SR
		Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'			Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'
Apr.1	Bal. b/f		200			Jun.30	Income A/c Distrib.	200			
Jun.30	Income A/c	200				Nov.30	Contra				4,500
Sep.30	Income A/c	300				Nov.30	12% Kenya stock			6,650	
Nov.30	E.A.B. Ltd			4,400		2003					
Nov.30	K.E Ltd.				4,500	Feb.28	Inv. In ICDCI shares		2,450		
Nov.30	Contra		2,250	2,250		Mar.31	Inc. A/c expenses	120			
Dec.31	Income A/c	180				Mar.31	Inc. A/c – K 201				
Dec.31	Income A/c	42				Mar.31	Inc. A/c – M 201	402			
		<u>722</u>	<u>2,450</u>	<u>6,650</u>	<u>4,500</u>			<u>722</u>	<u>2,450</u>	<u>6,650</u>	<u>4,500</u>

Income Account

2002		Sh.'000'	2002		Sh.'000'
June 30	CB: School fees paid for K & M	200	June 30	CB: Interest on 10% Kenya Stock	200
2003			Sep. 30	CB: Final dividend on EABL shares	300
Mar. 31	CB: Expenses for the year paid	120	Dec. 31	CB: Interest on 9% Kenya Stock	180
Mar. 31	Distribution to K	201	Dec. 31	CB: Interest on Bank Deposit.	42
Mar. 31	Distribution to M	<u>201</u>			
		<u>722</u>			<u>722</u>

Trust Capital Account										
2002			FIF	WRF	SRF	2002				
			Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'		
						April	Bal b/f	4,000	4,000	3,000
						1	Inv. In EAB			
Nov,	Contra				4,500	Nov.	Ltd		400	
30						30	Shares: Surplus			
							Inv. In			1,500
2003	Bal. c/d	<u>6,250</u>	<u>6,650</u>	—		Nov.	Kilimanjaro	<u>2,250</u>	<u>2,250</u>	—
Mar						30	Ent: surplus			
31							Contr			
						Nov.				
						30		<u>6,250</u>	<u>6,650</u>	<u>4,500</u>
						2003				
						Apr.1	Bal b/d	<u>6,250</u>	<u>6,650</u>	

(b)

**Trust Statement of financial position
as at 31 March 2003**

		Sh.'000'	Sh.'000'
Fixed interest investment	Sh.2 million 10% Kenya stock 2007	2,000	
	Sh.2 million 9% Kenya stock 2006	1,800	
	Sh.2 million 12% Kenya stock 2008	<u>2,450</u>	6,250
Wider range investments	Sh.4.2 million 12% Kenya stock 2008	4,200	
	61,250 Sh.10 Ordinary shares in ICDCI Ltd	<u>2,450</u>	<u>6,650</u>
			<u>12,900</u>
Trust capital:			
Fixed interest fund			6,250
Wider range fund			<u>6,650</u>
			<u>12,900</u>

REINFORCEMENT QUESTIONS

QUESTION ONE

Onyango died ten years ago and by his will left the residue of his estate in trust for his children Abel and Beatrice in equal shares. The will directed that a child's share should be ascertained and discharged on reaching 21 years of age. The trustees were empowered to maintain the children out of income and to use their unfettered discretion in the choice of investments.

The following trial balance was extracted from the books as on 31st December 20X3:

	Shs	Shs
Investments on Estate Capital Account:		
20,000 shares of Shs.10 each in K Ltd.	220,000	
30,000 shares of Shs.10 each in L Ltd.	280,000	
Investment on Accumulation Accounts:		
1,000 shares of Shs.10 each in K Ltd.	10,100	
1,000 shares of Shs.10 each in L Ltd.	9,000	
Balance with bankers:		
on Estate Capital Account	20,000	
on Accumulation Accounts	5,000	
Estate Capital Account		520,000
Accumulation Accounts:		
Abel		15,000
Beatrice		<u>10,000</u>
	<u>545,000</u>	<u>545,000</u>

Abel attained 21 years of age on 31st March 20X4, on which date the middle market prices of the investments were:

K Ltd. Shs.12.50
L Ltd. Shs.10

Transactions in the three months ended 31st March 20X4 comprised:

- a. 1st January - Receipt of dividend of Shs.0.50 on each Shs.10 share in K Ltd.
- b. 31st January - Maintenance payments: Abel Shs.3,000; Beatrice Shs.2,000

On 31st March 20X4 the trustees revalued all the investments and discharged their liability to Abel by the transfer to him of:

- a. One-half of each of the investments held on capital account;
- b. Three fifths of each of the investments held on accumulation accounts, and
- c. Cash for the balance of the amount due to him.

You are required to write up the following accounts in the books of the Trust for the three months ended 31st March 20X4:

1. Estate capital account;
2. Accumulation accounts (in columnar form),and
3. Distribution account - Laertes

Ignore taxation.

(Total: 25 Marks)

QUESTION TWO

Abincha died on 31st March 20X5 and by his will he left the residue of his estate to his three sons, Bruce, Chris and Dan, in equal shares, contingent upon attaining the age of 18 years.

The trustees' powers of investment were restricted to "those investments authorised by law as suitable for trustees" except that the trustees could hold a plot of short leasehold land until a suitable time for its sale arose.

The will provided that the trustees could maintain the children out of the income of the trust and that on attaining the age of 18 years each son was to receive his share of the capital of the trust and the accumulated income due to him.

The trustees had divided the trust funds into equal, fixed interest and wider ranges under the terms of the Trustee Act. On 31st March 20X8 the statement of financial position of the trust was:

Capital accounts	Shs	Shs
Fixed Interest		250,000
Wider range		250,000
Special range		60,000
Accumulation accounts		
Bruce		8,000
Chris		12,000
Dan		12,000
Investments		
Fixed Interest at cost		
Sh.250,000 6% Government stock 20Y5	210,000	
Sh.40,000 4% National stock 20X8	39,000	
Wider range at cost		
10,000 Sh.10 Ordinary shares in G Ltd	219,000	
1,000 Sh.10 Ordinary shares in S Ltd	30,000	
Special range at cost		
Plot of land	60,000	
Accumulations at cost		
Sh.30,000 6% National stock 20Y5	24,360	
Bank balances		
Fixed Interest	1,000	
Wider range	1,000	
Accumulations	<u>7,640</u>	
	<u>592,000</u>	<u>592,000</u>

Bruce, the eldest son, attained the age of 18 years on 31st July 20X8 and the transactions of the trustees for the four months to that date were:

30th April 20X8 received a dividend of 5% on the shares in S Ltd. and half a year's interest on the holding of 6% Government stock 20Y5.

31st May 20X8	received Shs.120,000 being the net proceeds of the sale of the plot of land and Shs.35,000 being the net proceeds of the sale of the whole of the holding of shares in S Ltd.
10th June 20X8	purchased and paid for sufficient Ordinary shares of Shs.10 each in Z Ltd. at Shs.25 a wider range investment, and such an amount of 5% Government stock 20Y4 at 80, a narrower range investment, both prices including all costs, so that all the cash available for investment on capital funds was invested.
30th June 20X8	paid the following cheques for maintenance: Bruce Shs.1,500, Chris Shs.900 and Dan Shs.850; received a half year's interest on the holding of 4% National stock 20X8 on its conversion into 8% Government stock 20Y8 at par.
31st July 20X8	the trustees revalued the trust funds and appropriated Sh.230,000 of the holding of 6% Government stock 20Y5 and sufficient Ordinary Shs.10 shares in Z Ltd. to satisfy Bruce's share of the capital and paid him a cheque for the balance of accumulations due to him. Bruce had agreed to have transferred to himself, at a later date, the shares and stock appropriated in satisfaction of his share of the capital of the trust fund.

You ascertain that:

the mid-market values of the investments at 31st July 20X8 were:

Ordinary shares G Ltd.	Shs28
6% Government stock 20Y5	95
6% National stock 20Y5	94
Ordinary shares Z Ltd	Shs27.50
5% Government stock 20Y4	94
8% Government stock 20Y8	97 3/4

All necessary advice has been taken.

You are required to prepare for the 4 months ended 31st July 20X8:

- a. Cash account
- b. Estate Capital accounts (in columnar form)
- c. Accumulation accounts (in columnar form) and
- d. Statement of financial position of the trustees as at 31st July 20X8

(Total:30

Marks)

QUESTION THREE

Kamau died on 30 June 20X4, leaving a net estate of Shs.3,600,000 (after all legacies, duties, debts and other outgoing had been paid). By his will Kamau bequeathed the residue of his estate to his three sons, Maina, Njoroge and Karanja in equal shares; the will also contained a wide investment clause so that the provisions of the Trustee Act were not to be applied by the trustees of the estate.

At the date of Kamau's death all three residuary legatees were under 18 years of age, but Karanja (the eldest) became 18 on 31st March 20X6, when the trustees of Kamau's estate arranged to transfer to him his due share of the estate.

The following transactions affecting Kamau's estate, and the interests of his sons therein, occurred between 30

June 20X4 and 31 March 20X6:

Assets held in trust on capital account on 31 March 20X6:

	Shs
Shs.1,000,000 M Ltd 9% Debenture Stock at cost	830,000
Shs.1,500,000 N Ltd 10% Loan Stock at cost	1,480,000
Shs.1,800,000 O Ltd 6% Stock (as valued at 30 June 20X4)	1,100,000
Shs.300,000 P Ltd 6% Debenture Stock (as valued at 30 June 20X4)	<u>190,000</u>
	<u>3,600,000</u>

Income received from investments:

On general fund:	Year to 30 June 20X5	300,000
	9 months to 31 March 20X6	270,000
On accumulations:	Year to 30 June 20X5	Nil
	9 months to 31 March 20X6	25,200

Payments made for infants' maintenance:

	Maina Shs.	Njoroge Shs.	Karanja Shs.
31 December 20X4	15,000	5,000	10,000
30 June 20X5	15,000	25,000	30,000
31 December 20X5	20,000	40,000	50,000

On 1 July 20X5 the trustees purchased the following stocks out of accumulated income:

	Cost Shs.
Shs.70,000 M Ltd 9% Debenture Stock	61,000
Shs.150,000 N Ltd 10% Loan Stock	149,000

It was agreed that Karanja's entitlement would be satisfied as follows:

From General Fund

- a. One-third share of nominal values of N Ltd and O Ltd stocks.
- b. Sufficient M Ltd stock to cover balance due.

From Accumulations Fund

- a. All M Ltd stock held on fund.
- b. Sufficient cash to cover balance due.

On 31 March 20X6 the prices of the stocks held in trust were as follows:

M Ltd 9% Debenture stock	86-88
N Ltd 10% Loan Stock	94-96
O Ltd 6% Stock	58-60

P Ltd 6% Debenture Stock

56-58

From the above information prepare:

- a. The accumulations accounts (in columnar form) for the period from Kamau's death to 31 March 20X6 (which you may assume to be the date when the relevant distributions were made to Karanja); (6 Marks)
- b. Statements of distribution for:
 1. The general fund; and
 2. The accumulations fund;

Showing the items transferred to Karanja and the balances remaining in trust for Maina and Njoroge;

(10 marks)

- c. The trust statement of financial position showing the position immediately after the distribution to Karanja. (4 Marks)
(20 Marks)

CHECK YOUR ANSWERS WITH THOSE GIVEN IN LESSON 9 OF THE STUDY PACK

LESSON EIGHT

PENSION FUND

OBJECTIVES

At the end of this lesson, you should:

- Know the purpose of pension funds;
- Know how to prepare pension fund accounts.

CONTENTS

- Read the study text below.
- Attempt reinforcing questions at the end of the lesson.
- Compare your solutions with those given in Lesson 9.

STUDY TEXT

INTRODUCTION

Pension funds are normally set up to provide pension benefits to employees who have retired. The pension funds receive contributions mainly from employers and employees and the contributions are invested. Pension benefits are paid out of the contributions and investment income received.

FINAL ACCOUNTS

As pension funds are set up for a specific purpose, and not for trading, we do not prepare the normal income statement or the statement of financial position. The presentation for the final accounts are as per the requirements of IAS 26 (please see the appendix for other important definition) whereby instead of a trading profit and loss account we have the statement of changes in net assets. We also prepare the statement of net assets in the place of a statement of financial position.

The major emphasis in the past papers has been on the formats so please pay careful attention to the description.

FORMAT FOR FINAL ACCOUNTS

STATEMENT OF CHANGES IN NET ASSETS

ABC Pension Fund

Statement of Changes in Net assets for the year ended 31 December

	Sh. '000'	Sh. '000'
Contributions Received:		
- From employers: Normal	X	
- From employers: Additional	<u>X</u>	X
- From employees: Normal	X	
- From employees: Additional voluntary	<u>X</u>	X
Transfers in:		
- Group transfers in from other schemes	X	
- Individual transfers from other schemes	<u>X</u>	X
Investment income:		
- Income from fixed investment securities	X	
- Dividends from equities	X	
- Income from unit trusts	X	
- Net rents from properties	X	
- Interest on cash deposits	X	
- Share of profit/loss of trading subsidiary and joint venture	<u>X</u>	X
Other income:		
- Claims on term insurance policies	X	
- Sundry income	<u>X</u>	<u>X</u>
		X
Benefits payable:		
- Pensions	(X)	
- Commutation of pensions and lumpsum retirement benefits	(X)	
- Death benefits	(X)	
- Payments to and on a/c of leavers:		

Current liabilities			
Unpaid benefits	(X)		
Other current liabilities	(X)		
	(X)		
		X	
Net Assets		XX	
			X
Accumulated fund as at beginning of year			X
Net new money invested as per revenue a/c (including changes in market value of interests)			X
Accumulated fund as at year end			XX

Example

The following is the trial balance of Civil Servants Pension Fund as at 31 March 2005:

	Sh 000	Sh 000
Accumulated fund as at 1 April 2004		3,245
Land and buildings in the Central business district	2,000	
Pensions	390	
Income from fixed return securities		580
11% Treasury Stock	400	
Freehold Property (Developed with rental income housing units)	2,200	
Employers normal contribution		980
Employees additional voluntary contributions		200
Administration expenses	150	
Claims received on term insurance policies		21
Premiums paid on term insurance policies	49	
Term insurance policies	400	
Employers additional contributions		25
Employers normal contributions		300
Unpaid benefits		30
Group transfers in from other schemes		75
Individual transfers out to other schemes	5	
Debtors on investment transactions	16	
Commutation of pensions and lump sum retirement benefits	15	
Dividends received from equity investments		400
20,000 ordinary shares in Flamingo Airways	200	
Individual transfers in from other schemes		14
Income from unit trusts		70
Rental income from property		45
Group transfers out to other schemes	40	
Cash and demand deposits	35	
Tax paid on fund income	460	
Ksh.250, 000 loan stock in KVM	200	
Death benefits paid	15	
Creditors for investment transactions		22
Refund of contributions	28	
Investment in unit trusts	350	
Loan from HFCK to develop Property		1,000
Contributions due within 30 days	56	
Shares in Moyalematt Ltd 2.00		2
	<u>7,009</u>	<u>7,009</u>

Notes:

The fund owned 12,000 shares in Moyalematt, which were initially purchased for Shs.14, 000. These have been disposed of during the year. The only entries made in the books were in a debtor account and investment account since the shares are yet to be paid for.

The trustees felt the need to reflect the following market prices in the financial statements:

Loan stock in KVM – Market price index – 84.00

Shares in Flamingo Airways -Sh.9.75 per share.

Required:

- (a) Statement of changes in net assets for the year to 31 October 2005.
 (b) Statement of net assets as at 31 October 2005.

(20 Marks)

Note: This should be in compliance with IAS 26 – Accounting and reporting by retirement benefit plans.

Solution**Civil Servants Pension Fund****Statement of changes in net assets for the year to 31 October 2005**

	Sh. '000'	Sh. '000'
Contributions received:		
From employees: Normal	980	
From employers: Additional	<u>25</u>	
		1005
From employees: Normal	300	
From employers: Additional voluntary	<u>200</u>	
		500
Transfers in:		
Group transfers in from other schemes	75	
Individual transfers in from other Schemes	<u>14</u>	
		89
Investment income:		
Income from fixed interest securities	580	
Dividends from equities	400	
Income from unit trusts	70	
Rents from properties	<u>45</u>	
		1095
Other income: Claim on term insurance policies		<u>21</u>
		2710
Benefits payable:		
Pensions	(390)	
Commutation of pensions and lump sum retirement benefits	(15)	
Death benefits	(15)	
Payments to and on a/c of leavers:		
Refund of contributions	(28)	
Group transfers out to other schemes	(40)	
Individual transfers out to other schemes	<u>(5)</u>	
		<u>(493)</u>
		2217
Profit on investment disposals	2	
Changes in market values of investments:		
Loan stock in KVM	10	
Shares in Flamingo Airways	(5)	

Payments: Premiums on term insurance policies	(49)	(199)
: Admin expenses	<u>(150)</u>	2025
Taxation on income		<u>(460)</u>
Net change for the year		<u>1565</u>

Civil Servants Pension Fund
Statement of Net Assets as at 31 October 2005

	Sh. '000'	Sh. '000'
Investment Assets		
Fixed interest securities: 11% T.Stock	400	610
: KVM loan stock	<u>210</u>	195
Equity investments: Flamingo Airways shares		350
Unit trust investments		2200
Property: Freehold		35
Cash and demand deposits		400
Insurance policies		
Debtors on investment transactions	16	
Creditors for investment transactions	<u>(22)</u>	<u>(6)</u>
		3784
Fixed Assets		
Leasehold property in Nairobi CBD		<u>2000</u>
		5784
Long term borrowings		
HFCK Loan		<u>(1000)</u>
		4784
Current Assets:		
Contributions due within 30 days	<u>56</u>	
Current Liabilities		
Unpaid benefits	<u>(30)</u>	<u>26</u>
Net Assets		<u>4810</u>
Accumulated Fund at 1 Nov.2000		3245
Net new money invested per revenue a/c including changes in market value of investments		<u>1565</u>
Accumulated Fund at 31 October 2001		<u>4810</u>

Example

- (a) What meetings of creditors must be held and for what purpose in the course of a creditors' voluntary winding up? (7 marks)
- (b) The following trial balance was extracted from the accounting records of the XYZ Retirement Benefits Scheme for the year ended 30 September 2000.

	Sh. '000'	Sh. '000'
Accumulated fund as at 1 October 1999		461,560
Accrued expensed		240
Administrative expenses	2,840	
Cash and demand deposits	23,460	
Change in market value of investments	22,640	
Commutation and lump sum retirement benefits	4,820	
Contributions due within 30 days	4,940	
Employer normal contributions		36,480
Individual transfers in from other schemes		3,150
Individual transfers out to other schemes	1,860	
Investment income		47,400
Immovable property	132,320	
Kenya Government securities	263,605	
Members' nominal contributions		18,240
Members' additional voluntary contributions		4,560
Pensions	7,640	
Quoted equity investments	87,835	
Unpaid benefits		320
Unquoted equity investments	<u>19,990</u>	
	571,950	571,950

Required:

The statement of Changes in Net Assets (the Fund Account) for the year ended 30 September 2000 and a statement of Net Assets as at 30 September 2000, in accordance with International Accounting Standard 26 (Accounting and reporting by Retired Benefit Plans)

Hints:

The XYZ Retirement Benefits Scheme's accounting policies state that the reconciliation of the accumulated fund for the year is included in Statement of Net Assets and administrative expenses are included as the final item in the Statement of Charges in Net Assets. In all other respects, the format used is in conformity with that laid down in the Retirement Benefits Regulations in Retirement Benefits Act.

(11 marks)

(Total: 18 marks)

Solution

(a) The first meeting of creditors' voluntary winding up should be held on the same day when the members have passed a resolution to wind up the company or on the day after. In this meeting the creditors shall:

- Appoint amongst them a chairman
- Join the members to appoint a liquidator
- Join the members to appoint a committee of inspection of up to 5 people.

The directors must present to the members the statement of affairs and the list of creditors. The creditor may also terminate the liquidator earlier appointed by the members

- When the liquidation commenced the creditors shall meet one year after commencement to review the progress and attend to any pending matters. Such meetings are called by the liquidator.
- If the liquidation is not complete after one year the creditors shall meet after lapse of one year for all years in which the liquidation is incomplete.

- When the liquidation is complete the liquidator must call a final meeting and lay before the company and creditors the accounts of winding up.

(b) **XYZ Retirements benefit scheme.****Statement of changes in net assets as at 30 Sept. 2000**

	Sh. '000'	Sh. '000'
Contributions received:		
- From employers: Normal		36,480
- From employees: Normal	18,240	
- From employees: Additional voluntary	<u>4,560</u>	
		22,800
Transfers in:		
- Individual transfers in from other schemes		3,150
Investment income:		
- Sundry investment income		<u>47,400</u>
		109,830
Benefits payable:		
- Pensions	(7,640)	
- Commutations and lumpsum retirement benefits	(4,820)	
Payments to and a/c of leavers:		
- Individual transfers out to other schemes	<u>(1,860)</u>	
		(14,320)
		95,510
Changes in market values of investments		<u>(22,640)</u>
		72,870
Payments:		
- Admin expenses		<u>(2,840)</u>
Net change for the year		<u>70,030</u>

XYZ Retirements benefit scheme**Statement of financial position (statement of Net Assets) as at 30 Sept. 2000**

	Sh. '000'	Sh. '000'
Investment Assets:		
Fixed interest securities: Kenya Govt		263,605
Equity investments: quoted	87,835	
: unquoted	<u>19,990</u>	
		107,825
Cash and demand deposits		<u>23,460</u>
		394,890
Fixed assets		
Immovable property		<u>132,320</u>
		527,210
Current Assets		
Contributions due within 30 days	<u>4,940</u>	
Current liabilities		
Accrued expenses	(240)	
Unpaid benefits	<u>(320)</u>	
		<u>(560)</u>
		4,380
Net Assets		<u>531,590</u>
Accumulated fund at 1 October 1999		461,560
Net new money invested as per statement of cha. In NA		<u>70,030</u>
Accumulated fund at 30 Sept. 2000		<u>531,590</u>

REINFORCING QUESTIONS

- (a) Explain the following terms as used in bankruptcy acts:
- (i) Voluntary transfers (2 marks)
- (ii) Doctrine of reputed ownership (3 marks)
- (b) Wafanyakazi Retirement Benefit Scheme has provided you with the following extract of the trial balance for the year ended 31 October 2002:

	Sh.'000'	Sh.'000'
Accumulated fund as at 1 November 2001		461,560
Accrued expenses		240
Administration expenses	2,840	
Cash and demand deposits	23,460	
Change in market value of investments	22,640	
Lumpsum retirement benefits	4,820	
Contributions due in 30 days	4,940	
Normal contributions by:		36,480
Employer		18,240
Employees		3,150
Transfer in from other schemes		
Individual transfers out to other schemes	1,860	
Investment income		47,400
Immovable property	132,320	
Government securities (long-term)	263,605	
Members' voluntary contributions		4,560
Pension	7,640	
Equity investments: Quoted	87,835	
Unquoted	19,900	
Unpaid benefits		<u>320</u>
	<u>571,950</u>	<u>571,950</u>

Required:

- (i) Statement of changes in net assets for the year ended 31 October 2002. (8 marks)
- (ii) Statement of net assets as at 31 October 2002. (7 marks)
- (Total: 20 marks)**

CHECK YOUR ANSWERS WITH THOSE PROVIDED IN LESSON 9 OF THE STUDY PACK

**COMPREHENSIVE ASSIGNMENT NO. 4
TO BE SUBMITTED AFTER LESSON 8**

To be carried out under examination conditions and sent to the Distance Learning Administrator for marking by the University.

TIME ALLOWED: THREE HOURS.

ANSWER ALL QUESTIONS

QUESTION ONE

With reference to the provisions of the law of succession:

Define a will;

Give two short explanation of failure of legacies.

(5 marks)

Mr Ruare dies intestate, leaving his two wives Luky and chity whom he married under a system of law which permits polygamy. A third wife Beaty had predeceased him. Luky has three children Peter, Lowe and Ricci.

Beaty had two children Short and Tall. Chity has no children.

All the children are alive at the time of Mr. Ruare's death. The value of his personal and household effects was Sh.350,000 and the value of the net intestate estate was Sh.3,150,000.

Required:

A clear statement to show how Mr. Ruare's property would devolve. (15 marks)

QUESTION TWO

Lawi Kiprop's will stated that the residue of his estate, after legacies to his sons and daughters, should be held in trust. The trustees were authorized to retain any asset which was included in his estate but was not an authorized investment under the Trustee Act (Cap. 167 of the Law of Kenya). The residue of his estate handed over to the trustee on 1 May 2000 comprised the following:

	Probate value Sh. '000'
3,000 Ordinary shares in E.A Breweries Ltd. (quoted)	330
6,000 Ordinary shares in BAT (K) Ltd	540
Collection of medals won in athletics: gold, silver and bronze	130
Sh. 500,000 6% Nairobi City Council Stock	300
Leasehold house in Kileleshwa (21 years remaining on lease)	3,750

	Probate value Sh. '000'
Leasehold house in Peponi (20 years remaining on lease)	4,250
1,500 Ordinary shares in Laki Ltd. (a private company)	450
2,500 ordinary shares in Wiro Ltd. (a private company)	600
Shares in Fidelity Building Society	300
Sh. 500,000 12% Kenya Stock 2005	1,020
Sh. 1,000,000 10% Kenya Stock 2002	274
Cash at bank	12,534

Additional information:

- The market values of the assets above were the same as the probate values except for the shares in E.A Breweries and in BAT (K) which were quoted at Sh. 118 – 122 and Sh. 94 – 98 respectively, the 6%

Nairobi City Council Stock which was quoted at Sh. 54 – 58 and the 12% Kenya Stock and 10% Kenya Stock which were quoted at Sh. 108 – 112 and Sh. 98 – 102 respectively.

2. On 1 May 2000, the trustees decided to divide the trust into the Special Range, Fixed Interest and Wider Range parts; any necessary balancing adjustments between the funds should be made firstly in cash and then in 10% Kenya Stock 2005.
3. On 15 June 2000, the trustees sold the medals Kiprop had won in athletics for Sh. 200,000.
4. On 30 September 2000, the tenants of the house in Kileleshwa moved out of the house. It was sold for Sh. 3,900,000 on 31 October 2005.
5. On 31 December 2000, the tenant of the house in Peponi purchased the house, after he obtained an extension of the lease for 50 years from the commissioner of Lands. The agreed sale price was Sh. 6,000,000. The tenant paid Sh. 3,000,000 to the Trustees. The remainder of the purchase price was a mortgage loan to the tenant repayable over 6 years. Interest being charged at 15% per annum.
6. The trustees purchased 45,700 ordinary shares in the Nation media Group at Sh. 120 per share on 31 December 2000, on which date the market values of all the other investments were the same as on 1 May 2000. In addition, the trustees used the balance of the cash available to purchase Kenya Government Treasury Bills. When matured, they would be rolled over.
7. On 28 February 2001, the trustees decided to liquidate the building society share account to use the proceeds to pay the University fees of one on the beneficiaries of the trust. This transaction was completed on 1 March 2001, with no capital profit or loss being made.
8. On 30 April 2001, the purchaser of the Peponi house repaid Sh. 500,000 of the mortgage loan. This amount was immediately invested in Treasury Bills.

Required:

- (a). Prepare a schedule to show the division of the assets on 1 May 2000. (5 marks)
- (b). Write up the Trust Capital Account in columnar form for the year ended 30 April 2001. Commencing with the probate value balance. (10 marks)
- (c). Write up the Trust Cash Book for the year ended 30 April, commencing with the balance of cash after the division on 1 May 2000. (5 marks)
- (d). Prepare the Trust Statement of financial position as at 30 April 2001. (5 marks)

(Total: 25 marks)

QUESTION THREE

Philip Muniu, a widower, died on 1 March 1991. He will left the residue of his estate to his three children, Abel, Beatrice and Cain. Since the children were infants when he died, the residue was to be held in trust; each child would obtain an absolute interest in one-third of the property at age eighteen. Philip's brother Stephen, was appointed trustee with unrestricted powers of investment: payments out of income were to be made for the children's maintenance.

The balances in the books of trust as 1 March 1993 were as follows:

	Sh.	Sh.
Capital investments:		
6,000 shares in Nairobi Printers Ltd.	492,000	
3,000 shares in Kenbreweries Ltd.	741,000	
Sh.450,000 nominal 8% Kenya stock 1998	387,000	
Accumulation Investments:		
Sh.126,000 nominal 8% Kenya stock 1998	112,560	
Cash at bank	7,440	
Capital account		1,620,000
Accumulation account: Abel		60,000
Beatrice		30,000
Cain		30,000
	<u>1,740,000</u>	<u>1,740,000</u>

The trust investment are to be revalued as at 31 October 1994. Abel would be given an appropriate investment to be decided upon.

In the 20 months period to 31 October 1994, the following occurred:

1. Interest on the holdings of 8% Kenya stock was received on the due dates 30 March and 30 September.

2. Dividend income was received as follows:

Year to 1 March 1994	Sh.51,840
8 months to 31 October 1994	Sh.17,100

3. Maintenance payments in respect of the 3 beneficiaries were made as follows:

	Abel	Beatrice	Cain
	Sh.	Sh.	Sh.
Year to 1 March 1994	22,320	19,800	36,000
8 months to 31 October 1994	20,562	16,036	19,130

4. On 1 March 1994, the trustees invested all available cash in 8% Kenya stock 1998 at Sh.90 cum interest.

Required:

Write up the beneficiaries Accumulation Accounts (in columnar form), the Income Account (using one column for accumulations income and another for capital income and the Capital Account for 20 months period. Balance the accounts at 1 March 1994 and show clearly any balance brought down at 2 March 1994. (15 marks)

The Trust statement of financial position immediately prior to the distribution of assets to Abel, showing the total liability to Abel in a Distribution Account.

QUESTION FOUR

The parents of Huyu, wale and Hao died in March 1998. Friends and well wishers organized a fund-raising in May 1998 which raised Sh. 3,960,000. This money was to cater for the welfare of the three orphans, Mr. Kilimo, who was appointed the trustee, invested this amount as follows.

	Sh
9,600 ordinary shares of Sh. 10 per value in Fimbo Ltd.	864,000
12,600 ordinary shares of Sh. 10 per value in Lima Ltd.	1,512,000
13,200 ordinary shares of Sh. 10 per value in Pewa Ltd.	<u>1,584,000</u>
	<u>3,960,000</u>

Mr Kilimo also established an accumulation and maintenance trust to hold these investments on behalf of the children. The trust had a wide investment clause. The accounts were to be made to 30 April each year. When a beneficiary reached the age of 21 years, Mr. Kilimo would transfer the share of the fund due to him/her. Huyu turned 21 years on 30 April 2002.

The balances on the accumulation fund for Huyu, Wale and Hao and Hao as at March 2001 were SH. 414,000, Sh. 207,900 and Sh. 69,300 respectively. To that date, Mr. Kilimo had used accumulated income to purchase 5,775 ordinary shares of Sh. 10 per value in Pewa Ltd.

In the year to 30 April 2002, Sh. 445,500 was received from capital investments and Sh. 124,740 from accumulation investments. Maintenance payments were made as follows:

Huyu	Sh. 154,000
Wale	Sh. 162,000
Hao	Sh. 188,000

On 30 April 2002, the market value of the shares in the companies, all listed at Nyumbani stock Exchange (NSE) were as follows:

Fimbo	Sh. 120 per share
Lima	Sh. 160 per share
Pewa	Sh. 140 per share

Huyu was to receive 10,000 shares of Sh. 10 per value in Lima Ltd. and the balance due to him on capital would be made up of the shares in Fimbo Ltd. Out of the accumulation assets, Huyu was to receive Sh. 64,444 in cash and the balance in shares in the Pewa Ltd.

Required:

(a). The beneficiaries and accumulation accounts for the period ended 30 April 2002.(10 marks)

(b). The distribution statements for the capital and accumulation assets as at 30 April 2002.

(10 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Briefly explain the meaning of the tem “abatement” (2 marks)
- (b) Identify and explain the four classifications of legacies. (8 marks)
- (c) The following trial balance was extracted from the books of ABC Retirement Benefits Scheme for the year ended 30 September 2003:

	Sh.	Sh.
Accumulated fund – 1 October 2002		461,560
Accrued expenses		240
General administrative expenses	2,840	
Cash and demand deposits	23,460	
Change in market value of investments	22,640	
Commutations and lumpsum retirement benefits	4,820	
Contributions due within 30 days	4,940	
Employer's normal contributions		36,480
Individual transfers in from other schemes		3,150
Individual transfers out of other schemes	1,860	
Investment income		47,400
Immovable property	132,320	
Government securities	263,605	
Members' normal contributions		18,240
Members' additional voluntary contributions		4,560
Pensions	7,640	
Equity investments – quoted	87,835	
Unpaid benefits		320
Equity investments – unquoted	<u>19,990</u>	
	<u>571,950</u>	<u>571,950</u>

Required:

- (i) Statement of changes in net assets as at 30 September 2003. (6 marks)
- (ii) Statement of net assets as at 30 September 2003. (4 marks)

[(i) and (ii) above should be in conformity with the requirements of IAS 26 – Accounting and Reporting by Retirement Benefit Plans]

**END OF COMPREHENSIVE ASSIGNMENT No.4
NOW SEND YOUR ANSWERS TO DISTANCE LEARNING FOR MARKING**

LESSON NINE

REVISION AID

CONTENTS

KASNEB SYLLABUS

SUMMARY OF RELEVANT STANDARDS

MODEL ANSWERS TO REINFORCING QUESTIONS

- LESSON 1
- LESSON 2
- LESSON 3
- LESSON 4
- LESSON 5
- LESSON 6
- LESSON 7
- LESSON 8

MOCK EXAMINATION

KASNEB SYLLABUS

OBJECTIVE

To examine candidates' understanding of various institutional group accounts and their ability to apply the law and accounting standards to published accounts of such entities; receiverships, bankruptcies and liquidation accounts; executorship and trust accounts.

CONTENT

Legal and Institutional Framework of Financial Accounting

- The preparation of financial statements in accordance with the provisions of the Companies Act, and legislation relating to other accounting entities. International and other relevant Accounting standards.
- Sources and authority of such standards.

Partnership Accounts

The more complex aspects of partnership accounting concerned with realignment and dissolutions. Conversion of partnership to a limited liability company. The provision of the Partnership Acts. Branch and departmental accounts.

Group Accounts

The legal and institutional requirements, the consolidated profit and loss account, statement of financial position, and statement of sources and application of Funds; Accounting for associated companies. Published group accounts.

Accounting for business combinations: the acquisition (Purchase) method versus merger (Pooling of interests) method.

Bankruptcy, Receivership and Liquidation

Acts of Bankruptcy; the petition: the receiving order, powers and duties of the official receiver; scheme of composition; deeds of arrangement; the adjudication for debtors.

The trustee; appointment, rights to the property of the bankrupt; duties, powers and privileges and removal.

Transactions voidable by the trustee. Provable and non-provable debts; priority debts; dividends, small bankruptcy offenses; discharge; cost and appeals. Bankruptcy accounts: Statements of affairs and deficiency accounts.

Executorship and Trust Accounts

The provisions of the law of Succession Act; Wills and probate; validity of wills; testamentary capacity. Distribution of the estate payments of debts; solvent and insolvent estates; priority of creditors and beneficiaries; Ademption and satisfaction; marshalling; abatement; time for distribution and future legacies. Accounts for the executor; expenses and distribution statements. The law of trusts; classification of trusts, creation; essentials; secret, protective and charitable trusts; appointment and capacity of trustees. Duties of trustees; investment of trust funds, maintenance and advancement. Control of trustees, liabilities and remedies for breach of trust.

Trustee's accounts; Appreciation of Trustees Investment Act.

SUMMARIES OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)/ INTERNATIONAL ACCOUNTING STANDARDS (IASs)

Statements of International Accounting Standards issued by the Board of the International Accounting Standards Committee (IASC) between 1973 and 2001 are designated "*International Accounting Standards*" (**IAS**).

The International Accounting Standards Board (IASB) announced in April 2001 that its accounting standards would be designated "*International Financial Reporting Standards*" (**IFRS**). Also in April 2001, the IASB announced that it would adopt all of the International Accounting Standards issued by the IASC.

IFRS 3: Business Combinations (Replaced IAS 22 Business Combinations)

Introduction:

IFRS 3 *Business Combinations* was issued in March 2004 and is applicable for business combinations for which the agreement date is on or after 31 March 2004.

IFRS 3 prescribes the financial reporting by an entity when it undertakes a business combination. A business combination is the bringing together of separate entities or businesses into one reporting entity. IFRS 3 does not apply to:

- business combinations in which separate entities or businesses are brought together to form a joint venture;
- business combinations involving entities or businesses under common control;
- business combinations involving two or more mutual entities; and
- business combinations in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.

Summary of IFRS 3:

Scope

Definition of business combination. A business combination is the bringing together of separate entities or businesses into one reporting entity. [IFRS 3.4]

Scope exclusions. IFRS 3 applies to all business combinations except combinations of entities under common control, combinations of mutual entities, combinations by contract without exchange of ownership interest, and formations of joint ventures. [IFRS 3.3]

Method of Accounting for Business Combinations

Purchase method. All business combinations within the scope of IFRS 3 must be accounted for using the purchase method. [IFRS 3.14] The pooling of interests method is prohibited.

Acquirer must be identified. The old IAS 22 had required the pooling method if an acquirer could not be identified. Under IFRS 3, an acquirer must be identified for all business combinations. [IFRS 3.17]

Identification of an Acquirer

Control. The acquirer is the combining entity that obtains control of the other combining entities or businesses. [IFRS 3.17] IFRS 3 provides considerable guidance for identifying the acquirer [IFRS 3.19-23]

Cost of a Business Combination

Fair value of consideration given plus costs. The acquirer measures the cost of a business combination at the sum of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus any costs directly attributable to the combination. [IFRS 3.24] If equity instruments are issued as consideration for the acquisition, the market price of those equity instruments at the date of exchange is considered to provide the best evidence of fair value. If a market price does not exist, or is not considered reliable, other valuation techniques are used to measure fair value. [IFRS 3.27]

Cost adjustments contingent on future events. If the cost is subject to adjustment contingent on future events, the acquirer includes the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably. [IFRS 3.32] However, if the contingent payment either is not probable or cannot be measured reliably, it is not measured as part of the initial cost of the business combination. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration is treated as an adjustment to the cost of the combination. [IAS 3.34]

Recognition and Measurement of Identifiable Acquired Assets and Liabilities

Recognition of acquired assets and liabilities. The acquirer recognises separately, at the acquisition date, the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the following recognition criteria at that date, regardless of whether they had been previously recognised in the acquiree's financial statements: [IAS 3.37]

- an asset other than an intangible asset is recognised if it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;
- a liability other than a contingent liability is recognised if it is probable that an outflow of resources will be required to settle the obligation, and its fair value can be measured reliably; and
- an intangible asset or a contingent liability is recognised if its fair value can be measured reliably.

Measurement of acquired assets and liabilities. The acquired identifiable assets, liabilities, and contingent liabilities are measured initially by the acquirer at their fair values at the acquisition date, irrespective of the extent of any minority interest. In other words, the identifiable assets acquired, and liabilities and contingent liabilities incurred or assumed, must be initially measured at full fair value, including any minority interest's share of the acquired item.

No restructuring provisions. In applying the purchase method, an acquirer must not recognise provisions for future losses or restructuring costs expected to be incurred as a result of the business combination. These must be treated as post-combination expenses. [IFRS 3.41]

Recognition of intangibles. In applying the purchase method, an intangible item acquired in a business combination, including an in-process research and development project, must be recognised as an asset separately from goodwill if it meets the definition of an asset (it is controlled and provides economic benefits), is either separable or arises from contractual or other legal rights, and its fair value can be measured reliably. [IFRS 3.45]

Recognition of contingent liabilities. In applying the purchase method, an acquirer must recognise contingent liabilities assumed in the business combination, if their fair value is reliably measurable. [IFRS 3.47] After their initial recognition, such contingent liabilities must be remeasured at the higher of: [IFRS 3.48]

-
- (a) the amount that would be recognised in accordance with IAS 37, and
 - (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 Revenue.

A contingent liability recognised under IFRS 3 continues to be recognised in subsequent periods even though it does not qualify for recognition under IAS 37.

Step acquisitions. If a business combination involves more than one exchange transaction, each exchange transaction shall be treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. [IFRS 3.58]

Goodwill

Recognition and measurement of goodwill. Goodwill is recognised by the acquirer as an asset from the acquisition date and is initially measured as the excess of the cost of the business combination over the acquirer's share of the net fair values of the acquiree's identifiable assets, liabilities and contingent liabilities. [IFRS 3.51]

No amortisation of goodwill. IFRS 3 prohibits the amortisation of goodwill. Instead goodwill must be tested for impairment at least annually in accordance with IAS 36 Impairment of Assets. [IFRS 3.54]

Negative goodwill. If the acquirer's interest in the net fair value of the acquired identifiable net assets exceeds the cost of the business combination, that excess (sometimes referred to as negative goodwill) must be recognised immediately in the income statement as a gain. Before concluding that "negative goodwill" has arisen, however, IFRS 3 requires that the acquirer reassess the identification and measurement of the acquiree's identifiable assets, liabilities, and contingent liabilities and the measurement of the cost of the combination. [IFRS 3.56]

Disclosure

For each business combination (or in the aggregate for immaterial combinations), required disclosures by the acquirer include: [IFRS 3.67]

Names and descriptions of the combining entities or businesses.

Acquisition date.

Percentage of voting equity instruments acquired.

Cost of the combination (with separate disclosure of the number and fair values of equity instruments issued and how fair values were determined)

Amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities, and contingent liabilities, and, unless impracticable, the carrying amounts of each of those classes, determined in accordance with IFRSs, immediately before the combination.

Amount of any negative goodwill recognised in profit or loss

Details about the factors that contributed to recognition of goodwill

Amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless impracticable.

The following must also be disclosed unless impracticable: [IFRS 3.70]

Revenue of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of that period.

Profit or loss of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of the period

IAS 1 Presentation of Financial Statements (revised 2003)

Objective of IAS 1

The objective of IAS 1 (revised 1997) is to prescribe the basis for presentation of general purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. IAS 1 sets out the overall framework and responsibilities for the presentation of financial statements, guidelines for their structure and minimum requirements for the content of the financial statements. Standards for recognising, measuring, and disclosing specific transactions are addressed in other Standards and Interpretations.

Scope

Applies to all general purpose financial statements based on International Financial Reporting Standards. [IAS 1.2]

General purpose financial statements are those intended to serve users who do not have the authority to demand financial reports tailored for their own needs. [IAS 1.3]

Objective of Financial Statements

The objective of general purpose financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet that objective, financial statements provide information about an entity's: [IAS 1.7]

- Assets.
- Liabilities.
- Equity.
- Income and expenses, including gains and losses.
- Other changes in equity.
- Cash flows.

That information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

Components of Financial Statements

A complete set of financial statements should include: [IAS 1.8]

- a statement of financial position,
- income statement,
- a statement of changes in equity showing either:
 - all changes in equity, or
 - changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders;
- cash flow statement, and
- notes, comprising a summary of accounting policies and other explanatory notes.

Reports that are presented outside of the financial statements -- including financial reviews by management, environmental reports, and value added statements -- are outside the scope of IFRSs. [IAS 1.9-10]

Fair Presentation and Compliance with IFRSs

The financial statements must "present fairly" the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation. [IAS 1.13]

IAS 1 requires that an entity whose financial statements comply with IFRSs make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs. [IAS 1.14]

Inappropriate accounting policies are not rectified either by disclosure of the accounting policies used or by notes or explanatory material. [IAS 1.16]

IAS 1 acknowledges that, in extremely rare circumstances, management may conclude that compliance with an IFRS requirement would be so misleading that it would conflict with the objective of financial statements set out in the Framework. In such a case, the entity is required to depart from the IFRS requirement, with detailed disclosure of the nature, reasons, and impact of the departure. [IAS 1.17-18]

Going Concern

An entity preparing IFRS financial statements is presumed to be a going concern. If management has significant concerns about the entity's ability to continue as a going concern, the uncertainties must be disclosed. If management concludes that the entity is not a going concern, the financial statements should not be prepared on a going concern basis, in which case IAS 1 requires a series of disclosures. [IAS 1.23]

Accrual Basis of Accounting

IAS 1 requires that an entity prepare its financial statements, except for cash flow information, using the accrual basis of accounting. [IAS 1.25]

Consistency of Presentation

The presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new IFRS. [IAS 1.27]

Materiality and Aggregation

Each material class of similar items must be presented separately in the financial statements. Dissimilar items may be aggregated only if they are individually immaterial. [IAS 1.29]

Offsetting> Assets and liabilities, and income and expenses, may not be offset unless required or permitted by a Standard or an Interpretation. [IAS 1.32]

Comparative Information

IAS 1 requires that comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements, both face of financial statements and notes, unless another Standard requires otherwise. [IAS 1.36]

If comparative amounts are changed or reclassified, various disclosures are required. [IAS 1.38]

Structure and Content of Financial Statements in General

Clearly identify: [IAS 1.46]

- the financial statements
- the reporting enterprise
- whether the statements are for the enterprise or for a group
- the date or period covered
- the presentation currency
- the level of precision (thousands, millions, etc.)

Reporting Period

There is a presumption that financial statements will be prepared at least annually. If the annual reporting period changes and financial statements are prepared for a different period, the enterprise must disclose the reason for the change and a warning about problems of comparability. [IAS 1.49]

Statement of financial position

An entity must normally present a classified statement of financial position, separating current and noncurrent assets and liabilities. Only if a presentation based on liquidity provides information that is reliable and more relevant may the current/noncurrent split be omitted. [IAS 1.51] In either case, if an asset (liability) category commingles amounts that will be received (settled) after 12 months with assets (liabilities) that will be received (settled) within 12 months, note disclosure is required that separates the longer-term amounts from the 12-month amounts. [IAS 1.52]

Current assets are cash; cash equivalent; assets held for collection, sale, or consumption within the enterprise's normal operating cycle; or assets held for trading within the next 12 months. All other assets are noncurrent. [IAS 1.57]

Current liabilities are those to be settled within the enterprise's normal operating cycle or due within 12 months, or those held for trading, or those for which the entity does not have an unconditional right to defer payment beyond 12 months. Other liabilities are noncurrent. [IAS 1.60]

Long-term debt expected to be refinanced under an existing loan facility is noncurrent, even if due within 12 months. [IAS 1.64]

If a liability has become payable on demand because an entity has breached an undertaking under a long-term loan agreement on or before the statement of financial position date, the liability is current, even if the lender has agreed, after the statement of financial position date and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. [IAS 1.65] However, the liability is classified as non-current if the lender agreed by the statement of financial position date to provide a period of grace ending at least 12 months after the statement of financial position date, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment. [IA 1.66]

Minimum items on the face of the statement of financial position [IAS 1.68]

- (a) property, plant and equipment;
- (b) investment property;
- (c) intangible assets;
- (d) financial assets (excluding amounts shown under (e), (h) and (i));
- (e) investments accounted for using the equity method;
- (f) biological assets;
- (g) inventories;
- (h) trade and other receivables;
- (i) cash and cash equivalents;
- (j) trade and other payables;
- (k) provisions;
- (l) financial liabilities (excluding amounts shown under (j) and (k));
- (m) liabilities and assets for current tax, as defined in IAS 12;
- (n) deferred tax liabilities and deferred tax assets, as defined in IAS 12;
- (o) minority interest, presented within equity; and
- (p) issued capital and reserves attributable to equity holders of the parent.

Additional line items may be needed to fairly present the entity's financial position. [IAS 1.69]

IAS 1 does not prescribe the format of the statement of financial position. Assets can be presented current then noncurrent, or vice versa, and liabilities and equity can be presented current then noncurrent then equity, or vice versa. A net asset presentation (assets minus liabilities) is allowed. The long-term financing approach used in UK and elsewhere – fixed assets + current assets - short term payables = long-term debt plus equity – is also acceptable.

Regarding issued share capital and reserves, the following disclosures are required: [IAS 1.76]

- numbers of shares authorised, issued and fully paid, and issued but not fully paid
- par value
- reconciliation of shares outstanding at the beginning and the end of the period
- description of rights, preferences, and restrictions
- treasury shares, including shares held by subsidiaries and associates
- shares reserved for issuance under options and contracts
- a description of the nature and purpose of each reserve within owners' equity

Income Statement

In the 2003 revision to IAS 1, the IASB is now using "profit or loss" rather than "net profit or loss" as the descriptive term for the bottom line of the income statement.

All items of income and expense recognised in a period must be included in profit or loss unless a Standard or an Interpretation requires otherwise. [IAS 1.78]

Minimum items on the face of the income statement should include: [IAS 1.81]

- (a) revenue;
- (b) finance costs;
- (c) share of the profit or loss of associates and joint ventures accounted for using the equity method;
- (d) a single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post-tax gain or loss recognised on the disposal of the assets or disposal group(s) constituting the discontinued operation; and;

- (e) tax expense; and
- (f) profit or loss.

The following items must also be disclosed on the face of the income statement as allocations of profit or loss for the period: [IAS 1.82]

- (a) profit or loss attributable to minority interest; and
- (b) profit or loss attributable to equity holders of the parent.

Additional line items may be needed to fairly present the enterprise's results of operations.

No items may be presented on the face of the income statement or in the notes as "extraordinary items". [IAS 1.85]

Certain items must be disclosed either on the face of the income statement or in the notes, if material, including: [IAS 1.87]

- (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
- (c) disposals of items of property, plant and equipment;
- (d) disposals of investments;
- (e) discontinuing operations;
- (f) litigation settlements; and
- (g) other reversals of provisions.

Expenses should be analysed either by nature (raw materials, staffing costs, depreciation, etc.) or by function (cost of sales, selling, administrative, etc.) either on the face of the income statement or in the notes. [IAS 1.88] If an enterprise categorises by function, additional information on the nature of expenses -- a minimum depreciation, amortisation, and staff costs -- must be disclosed. [IAS 1.93]

Cash Flow Statement

Rather than setting out separate standards for presenting the cash flow statement, IAS 1.102 refers to IAS 7, Cash Flow Statements

Statement of Changes in Equity

IAS 1 requires an entity to present a statement of changes in equity as a separate component of the financial statements. The statement must show: [IAS 1.96]

- (a) profit or loss for the period;
- (b) each item of income and expense for the period that is recognised directly in equity, and the total of those items;
- (c) total income and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to equity holders of the parent and to minority interest; and
- (d) for each component of equity, the effects of changes in accounting policies and corrections of errors recognised in accordance with IAS 8.

The following amounts may also be presented on the face of the statement of changes in equity, or they may be presented in the notes: [IAS 1.97]

-
- (a) capital transactions with owners;
 - (b) the balance of accumulated profits at the beginning and at the end of the period, and the movements for the period; and
 - (c) a reconciliation between the carrying amount of each class of equity capital, share premium and each reserve at the beginning and at the end of the period, disclosing each movement.

Notes to the Financial Statements

The notes must: [IAS 1.103]

present information about the basis of preparation of the financial statements and the specific accounting policies used;
disclose any information required by IFRSs that is not presented on the face of the statement of financial position, income statement, statement of changes in equity, or cash flow statement; and
provide additional information that is not presented on the face of the statement of financial position, income statement, statement of changes in equity, or cash flow statement that is deemed relevant to an understanding of any of them.

Notes should be cross-referenced from the face of the financial statements to the relevant note. [IAS 1.104]

IAS 1.105 suggests that the notes should normally be presented in the following order:

- a statement of compliance with IFRSs;
- a summary of significant accounting policies applied, including: [IAS 1.108]
 - the measurement basis (or bases) used in preparing the financial statements; and
 - the other accounting policies used that are relevant to an understanding of the financial statements.
- supporting information for items presented on the face of the statement of financial position, income statement, statement of changes in equity, and cash flow statement, in the order in which each statement and each line item is presented; and
- other disclosures, including:
 - contingent liabilities (see IAS 37) and unrecognised contractual commitments; and
 - non-financial disclosures, such as the entity's financial risk management objectives and policies (see IAS 32).

Disclosure of judgements. New in the 2003 revision to IAS 1, an entity must disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements. [IAS 1.113]

Examples cited in IAS 1.114 include management's judgements in determining:

- whether financial assets are held-to-maturity investments;
- when substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities;
- whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and
- whether the substance of the relationship between the entity and a special purpose entity indicates that the special purpose entity is controlled by the entity.

Disclosure of key sources of estimation uncertainty. Also new in the 2003 revision to IAS 1, an entity must disclose, in the notes, information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the statement of financial position date, that have a significant risk of causing a

material adjustment to the carrying amounts of assets and liabilities within the next financial year. [IAS 1.116]
These disclosures do not involve disclosing budgets or forecasts.

The following other note disclosures are required by IAS 1.126 if not disclosed elsewhere in information published with the financial statements:

domicile of the enterprise;
country of incorporation;
address of registered office or principal place of business;
description of the enterprise's operations and principal activities;
name of its parent and the ultimate parent if it is part of a group.

Disclosures about Dividends

The following must be disclosed either on the face of the income statement or the statement of changes in equity or in the notes: [IAS 1.95]

the amount of dividends recognised as distributions to equity holders during the period, and the related amount per share.

The following must be disclosed in the notes: [IAS 1.125]

the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to equity holders during the period, and the related amount per share; and
the amount of any cumulative preference dividends not recognised.

August 2005 Amendments re Capital Disclosures

As part of its project to develop IERS 7 *Financial Instruments: Disclosures*, the IASB concluded also to amend IAS 1 to add requirements for disclosures of:

the entity's objectives, policies and processes for managing capital;
quantitative data about what the entity regards as capital;
whether the entity has complied with any capital requirements; and
if it has not complied, the consequences of such non-compliance.

These disclosure requirements apply to all entities, effective for annual periods beginning on or after 1 January 2007, with earlier application encouraged. Illustrative examples are provided as guidance.

IAS 2 Inventories (revised 2003)

Effective Date: Annual periods beginning on or after 1 January 2005.

Objective To prescribe the accounting treatment for inventories, including cost determination and expense recognition.

Summary • Inventories are required to be stated at the lower of cost and net realisable value.

- Costs include purchase cost, conversion cost (materials, labour, and overhead), and other costs to bring inventory to its present location and condition, but not foreign exchange differences.
- For inventory items that are not interchangeable, specific costs are attributed to the specific individual items of inventory.

- For interchangeable items, cost is determined on either a FIFO or weighted average basis. LIFO is not permitted.
- When inventories are sold, the carrying amount should be recognised as an expense in the period in which the related revenue is recognised.

Interpretations None.

IAS 7 Cash Flow Statements (revised 1992)

Objective of IAS 7

The objective of IAS 7 is to require the presentation of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period according to operating, investing and financing activities.

Fundamental Principle in IAS 7

All enterprises that prepare financial statements in conformity with IAS are required to present a cash flow statement. [IAS 7.1]

The cash flow statement analyses changes in cash and cash equivalents during a period. Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of changes in value. Guidance notes indicate that an investment normally meets the definition of a cash equivalent when it has a maturity of three months or less from the date of acquisition. Equity investments are normally excluded, unless they are in substance a cash equivalent (e.g. preferred shares acquired within three months of their specified redemption date). Bank overdrafts which are repayable on demand and which form an integral part of an enterprise's cash management are also included as a component of cash and cash equivalents. [IAS 7.7-8]

Presentation of the Cash Flow Statement

Cash flows must be analysed between operating, investing and financing activities. [IAS 7.10]

Key principles specified by IAS 7 for the preparation of a cash flow statement are as follows:

operating activities are the main revenue-producing activities of the enterprise that are not investing or financing activities, so operating cash flows include cash received from customers and cash paid to suppliers and employees [IAS 7.14]

investing activities are the acquisition and disposal of long-term assets and other investments that are not considered to be cash equivalents [IAS 7.6]

financing activities are activities that alter the equity capital and borrowing structure of the enterprise [IAS 7.6]

interest and dividends received and paid may be classified as operating, investing, or financing cash flows, provided that they are classified consistently from period to period [IAS 7.31]

cash flows arising from taxes on income are normally classified as operating, unless they can be specifically identified with financing or investing activities [IAS 7.35]

for operating cash flows, the direct method of presentation is encouraged, but the indirect method is acceptable [IAS 7.18]

The **direct method** shows each major class of gross cash receipts and gross cash payments. The operating cash flows section of the cash flow statement under the direct method would appear something like this:

Cash receipts from customers	xx,xxx
Cash paid to suppliers	xx,xxx
Cash paid to employees	xx,xxx
Cash paid for other operating expenses	xx,xxx
Interest paid	xx,xxx
Income taxes paid	xx,xxx
Net cash from operating activities	xx,xxx

The **indirect method** adjusts accrual basis net profit or loss for the effects of non-cash transactions. The operating cash flows section of the cash flow statement under the indirect method would appear something like this:

Profit before interest and income taxes	xx,xxx
Add back depreciation	xx,xxx
Add back amortisation of goodwill	xx,xxx
Increase in receivables	xx,xxx
Decrease in inventories	xx,xxx
Increase in trade payables	xx,xxx
Interest expense	xx,xxx
Less Interest accrued but not yet paid	<u>xx,xxx</u>
Interest paid	xx,xxx
Income taxes paid	xx,xxx
Net cash from operating activities	xx,xxx

cash flows relating to extraordinary items should be classified as operating, investing or financing as appropriate and should be separately disclosed [IAS 7.29]

the exchange rate used for translation of transactions denominated in a foreign currency and the cash flows of a foreign subsidiary should be the rate in effect at the date of the cash flows [IAS 7.25]

cash flows of foreign subsidiaries should be translated at the exchange rates prevailing when the cash flows took place [IAS 7.26]

as regards the cash flows of associates and joint ventures, where the equity method is used, the cash flow statement should report only cash flows between the investor and the investee; where proportionate consolidation is used, the cash flow statement should include the venturer's share of the cash flows of the investee [IAS 7.37-38]

aggregate cash flows relating to acquisitions and disposals of subsidiaries and other business units should be presented separately and classified as investing activities, with specified additional disclosures. The aggregate cash paid or received as consideration should be reported net of cash and cash equivalents acquired or disposed of [IAS 7.39]

cash flows from investing and financing activities should be reported gross by major class of cash receipts and major class of cash payments except for the following cases, which may be reported on a net basis: [IAS 7.22-24]

cash receipts and payments on behalf of customers (for example, receipt and repayment of demand deposits by banks, and receipts collected on behalf of and paid over to the owner of a property)

cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short, generally less than three months (for example, charges and collections from credit card customers, and purchase and sale of investments)

cash receipts and payments relating to fixed maturity deposits

cash advances and loans made to customers and repayments thereof

investing and financing transactions which do not require the use of cash should be excluded from the cash flow statement, but they should be separately disclosed elsewhere in the financial statements [IAS 7.43]

the components of cash and cash equivalents should be disclosed, and a reconciliation presented to amounts reported in the statement of financial position [IAS 7.45]

the amount of cash and cash equivalents held by the enterprise that is not available for use by the group should be disclosed, together with a commentary by management [IAS 7.48]

IAS 8 Accounting Policies, Changes in Accounting Estimates, and Errors (revised 2003)

Key Definitions [IAS 8.5]

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

A change in accounting estimate is an adjustment of the carrying amount of an asset or liability, or related expense, resulting from reassessing the expected future benefits and obligations associated with that asset or liability.

International Financial Reporting Standards are standards and interpretations adopted by the International Accounting Standards Board (IASB). They comprise:

International Financial Reporting Standards (IFRSs);

International Accounting Standards (IASs); and

Interpretations developed by the International Financial Reporting Interpretations

Committee (IFRIC) or the former Standing Interpretations Committee (SIC) and approved by the IASB.

Materiality. Omissions or misstatements of items are material if they could, by their size or nature, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements.

Prior period errors are omissions from, and misstatements in, an entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that was available and could reasonably be expected to have been obtained and taken into account in preparing those statements. Such errors result from mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Selection and Application of Accounting Policies

When a Standard or an Interpretation specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item must be determined by applying the Standard or Interpretation and considering any relevant Implementation Guidance issued by the IASB for the Standard or Interpretation. [IAS 8.7]

In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition, management must use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. [IAS 8.10]. In making that judgement, management must refer to, and consider the applicability of, the following sources in descending order:

the requirements and guidance in IASB standards and interpretations dealing with similar and related issues; and

the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework. [IAS 8.11]

Management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11. [IAS 8.12]

Consistency of Accounting Policies

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a Standard or an Interpretation specifically requires or permits categorisation of items for which different policies may be appropriate. If a Standard or an Interpretation requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category. [IAS 8.13]

Changes in Accounting Policies

An entity is permitted to change an accounting policy only if the change:

is required by a standard or interpretation; or
results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance, or cash flows. [IAS 8.14]

Note that changes in accounting policies do not include applying an accounting policy to a kind of transaction or event that did not exist in the past. [IAS 8.16]

If a change in accounting policy is required by a new IASB standard or interpretation, the change is accounted for as required by that new pronouncement or, if the new pronouncement does not include specific transition provisions, then the change in accounting policy is applied retrospectively. [IAS 8.19]

Retrospective application means adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied. [IAS 8.22]

However, if it is impracticable to determine either the period-specific effects or the cumulative effect of the change for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period. [IAS 8.24]

Also, if it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable. [IAS 8.25]

Disclosures Relating to Changes in Accounting Policies

Disclosures relating to changes in accounting policy caused by a new standard or interpretation include: [IAS 8.28]

the title of the standard or interpretation causing the change;
the nature of the change in accounting policy;
a description of the transitional provisions, including those that might have an effect on future periods;

for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

- for each financial statement line item affected; and

- for basic and diluted earnings per share (only if the entity is applying IAS 33);

the amount of the adjustment relating to periods before those presented, to the extent practicable; and

if retrospective application is impracticable, an explanation and description of how the change in accounting policy was applied.

Financial statements of subsequent periods need not repeat these disclosures.

Disclosures relating to voluntary changes in accounting policy include: [IAS 8.29]

- the nature of the change in accounting policy;

- the reasons why applying the new accounting policy provides reliable and more relevant information; for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

- for each financial statement line item affected; and

- for basic and diluted earnings per share (only if the entity is applying IAS 33);

the amount of the adjustment relating to periods before those presented, to the extent practicable; and

if retrospective application is impracticable, an explanation and description of how the change in accounting policy was applied.

Financial statements of subsequent periods need not repeat these disclosures.

If an entity has not applied a new standard or interpretation that has been issued but is not yet effective, the entity must disclose that fact and any and known or reasonably estimable information relevant to assessing the possible impact that the new pronouncement will have in the year it is applied. [IAS 8.30]

Changes in Accounting Estimate

The effect of a change in an accounting estimate shall be recognised prospectively by including it in profit or loss in: [IAS 8.36]

- the period of the change, if the change affects that period only; or

- the period of the change and future periods, if the change affects both.

However, to the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it is recognised by adjusting the carrying amount of the related asset, liability, or equity item in the period of the change. [IAS 8.37]

Disclosures Relating to Changes in Accounting Estimate

Disclose:

- the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods

- if the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact. [IAS 8.39-40]

Errors

The general principle in IAS 8 is that an entity must correct all material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by: [IAS 8.42]

restating the comparative amounts for the prior period(s) presented in which the error occurred; or if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

However, if it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity must restate the opening balances of assets, liabilities, and equity for the earliest period for which retrospective restatement is practicable (which may be the current period). [IAS 8.44]

Further, if it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity must restate the comparative information to correct the error prospectively from the earliest date practicable. [IAS 8.45]

Disclosures Relating to Prior Period Errors

Disclosures relating to prior period errors include: [IAS 8.49]

the nature of the prior period error;
for each prior period presented, to the extent practicable, the amount of the correction:
 for each financial statement line item affected; and
 for basic and diluted earnings per share (only if the entity is applying IAS 33);
the amount of the correction at the beginning of the earliest prior period presented; and
if retrospective restatement is impracticable, an explanation and description of how the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.

IAS 10 Events After the Statement of financial position Date (revised 2003)

Event after the statement of financial position date: An event, which could be favourable or unfavourable, that occurs between the statement of financial position date and the date that the financial statements are authorised for issue. [IAS 10.3]

Adjusting event: An event after the statement of financial position date that provides further evidence of conditions that existed at the statement of financial position, including an event that indicates that the going concern assumption in relation to the whole or part of the enterprise is not appropriate. [IAS 10.3]

Non-adjusting event: An event after the statement of financial position date that is indicative of a condition that arose after the statement of financial position date. [IAS 10.3]

Accounting

Adjust financial statements for adjusting events – events after the statement of financial position date that provide further evidence of conditions that existed at the statement of financial position, including events that indicate that the going concern assumption in relation to the whole or part of the enterprise is not appropriate. [IAS 10.8]

Do not adjust for non-adjusting events – events or conditions that arose after the statement of financial position date. [IAS 10.10]

If an entity declares dividends after the statement of financial position date, the entity shall not recognise those dividends as a liability at the statement of financial position date. That is a non-adjusting event. [IAS 10.12]

Going Concern Issues Arising After Statement of financial position Date

An entity shall not prepare its financial statements on a going concern basis if management determines after the statement of financial position date either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so. [IAS 10.14]

Disclosure

Non-adjusting events should be disclosed if they are of such importance that non-disclosure would affect the ability of users to make proper evaluations and decisions. The required disclosure is (a) the nature of the event and (b) an estimate of its financial effect or a statement that a reasonable estimate of the effect cannot be made. [IAS 10.21]

A company should update disclosures that relate to conditions that existed at the statement of financial position date to reflect any new information that it receives after the statement of financial position date about those conditions. [IAS 10.19]

Companies must disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the enterprise's owners or others have the power to amend the financial statements after issuance, the enterprise must disclose that fact. [IAS 10.17]

IAS 12 Income Taxes (revised 2000)

Effective Date Periods beginning on or after 1 January 1998. Certain revisions effective for periods beginning on or after 1 January 2001.

Objective To prescribe the accounting treatment for income taxes. To establish the principles and provide guidance in accounting for the current and future income tax consequences related to:

- the future recovery (settlement) of carrying amounts of assets (liabilities) in an entity's statement of financial position, and
- current period transactions recognised in the income statement or directly through equity.

Summary • Current tax liabilities and assets should be recognised for current and prior period taxes, measured at the rates applicable for the period.

- A temporary difference is a difference between the carrying amount of an asset or liability and its tax base.
- Deferred tax liabilities must be recognized for the future tax consequences of all taxable temporary differences with three exceptions:
 - liabilities arising from the initial recognition of goodwill;
 - liabilities arising from the initial recognition of an asset/liability other than in a business combination which, at the time of the transaction, does not affect either the accounting or the taxable profit; and
 - liabilities arising from undistributed profits from investments where the enterprise is able to control the timing of the reversal of the difference and it is probable that the reversal will not occur in the foreseeable future.
- A deferred tax asset must be recognized for deductible temporary differences, unused tax losses, and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized, with this exception:
 - the deferred tax asset arises from the initial recognition of an asset/liability, other than in a business combination, which at the time of the transaction, does not affect the accounting or the taxable profit.

- Deferred tax liabilities (assets) should be measured at the tax rates expected to apply when the liability is settled or asset is realised, based on tax rates/laws that have been enacted or substantively enacted by the statement of financial position date.
- Discounting of deferred tax assets and liabilities is prohibited.
- Deferred taxes must be presented as non current items in the statement of financial position.
- IAS 12 specifies detailed disclosure requirements for income taxes.

IAS 21 The Effects of Changes in Foreign Exchange Rates (revised 2003)

Effective Date Annual periods beginning on or after 1 January 2005.

Objective To prescribe the accounting treatment for an entity's foreign currency transactions and foreign operations.

Summary • First, determine reporting entity's functional currency.

- Then translate all foreign currency items into the functional currency:
 - At date of transaction, record using the transaction-date exchange rate for initial recognition and measurement.
 - At subsequent statement of financial position dates: use closing rate for monetary items; use transaction-date exchange rates for non-monetary items carried at historical cost; and use valuation-date exchange rates for non-monetary items that are carried at fair value.
 - Exchange differences arising on settlement of monetary items and on translation of monetary items at a rate different than when initially recognised are included in net profit or loss, with one exception: exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognised in the consolidated financial statements that include the foreign operation in a separate component of equity; they will be recognised in profit or loss on disposal of the net investment.
- The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency using the following procedures:
 - assets and liabilities for each statement of financial position presented (including comparatives) are translated at the closing rate at the date of that statement of financial position;
 - income and expenses for each income statement (including comparatives) are translated at exchange rates at the dates of the transactions; and
 - all resulting exchange differences are recognised as a separate component of equity.
- Special rules for translating into a presentation currency the results and financial position of an entity whose functional currency is hyperinflationary.

Summary of IAS 26 Accounting and Reporting by Retirement Benefit Plans and important definitions

Objective of IAS 26

The objective of IAS 26 is to specify measurement and disclosure principles for the reports of retirement benefit plans. All plans should include in their reports a statement of changes in net assets available for benefits, a summary of significant accounting policies and a description of the plan and the effect of any changes in the plan during the period.

Key Definitions

Retirement benefit plan: An arrangement by which an enterprise provides benefits (annual income or lump sum) to employees after they terminate from service.

Defined Contribution Plan: A retirement benefit plan by which benefits to employees are based on the amount of funds contributed to the plan by the employer plus earnings thereon.

Defined Benefit Plan: A retirement benefit plan by which employees receive benefits based on a formula usually linked to employee earnings.

Defined Contribution Plans

The report of a defined contribution plan should contain a statement of net assets available for benefits and a description of the funding policy.

Defined Benefit Plans

The report of a defined benefit plan should contain either:

- a statement that shows the net assets available for benefits, the actuarial present value of promised retirement benefits (distinguishing between vested benefits and non-vested benefits) and the resulting excess or deficit; or
- a statement of net assets available for benefits, including either a note disclosing the actuarial present value of promised retirement benefits (distinguishing between vested benefits and non-vested benefits) or a reference to this information in an accompanying actuarial report.

If an actuarial valuation has not been prepared at the date of the report of a defined benefit plan, the most recent valuation should be used as a base and the date of the valuation disclosed. The actuarial present value of promised retirement benefits should be based on the benefits promised under the terms of the plan on service rendered to date, using either current salary levels or projected salary levels, with disclosure of the basis used. The effect of any changes in actuarial assumptions that have had a significant effect on the actuarial present value of promised retirement benefits should also be disclosed.

The report should explain the relationship between the actuarial present value of promised retirement benefits and the net assets available for benefits, and the policy for the funding of promised benefits.

Retirement benefit plan investments should be carried at fair value. For marketable securities, fair value means market value. If fair values cannot be estimated for certain retirement benefit plan investments, disclosure should be made of the reason why fair value is not used.

Disclosure

Statement of net assets available for benefit, showing:

- assets at the end of the period
- basis of valuation
- details of any single investment exceeding 5% of net assets or 5% of any category of investment
- details of investment in the employer
- liabilities other than the actuarial present value of plan benefits

Statement of changes in net assets available for benefits, showing:

- employer contributions
- employee contributions
- investment income
- other income
- benefits paid
- administrative expenses

other expenses
 income taxes
 profit or loss on disposal of investments
 changes in fair value of investments
 transfers to/from other plans
 Description of funding policy
 Other details about the plan
 Summary of significant accounting policies
 Description of the plan and of the effect of any changes in the plan during the period
 Disclosures for defined benefit plans:
 actuarial present value of promised benefit obligations
 description of actuarial assumptions
 description of the method used to calculate the actuarial present value of promised benefit obligations

IAS 27 Consolidated and Separate Financial Statements (revised 2003)

IAS 27 has the twin objectives of setting standards to be applied:

in the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent; and
 in accounting for investments in subsidiaries, jointly controlled entities, and associates when an entity elects, or is required by local regulations, to present separate (non-consolidated) financial statements.

Key Definitions [IAS 27.4]

Consolidated financial statements: The financial statements of a group presented as those of a single economic entity.

Subsidiary: An entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

Parent: An entity that has one or more subsidiaries.

Control: The power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

Identification of Subsidiaries

Control is presumed when the parent acquires more than half of the voting rights of the enterprise. Even when more than one half of the voting rights is not acquired, control may be evidenced by power: [IAS 27.13]

over more than one half of the voting rights by virtue of an agreement with other investors; or
 to govern the financial and operating policies of the other enterprise under a statute or an agreement;
 or
 to appoint or remove the majority of the members of the board of directors; or
 to cast the majority of votes at a meeting of the board of directors.

Presentation of Consolidated Accounts

A parent is required to present consolidated financial statements in which it consolidates its investments in subsidiaries [IAS 27.9] – except in one circumstance: A parent is not required to (but may) present consolidated financial statements if and only if all of the following four conditions are met: [IAS 27.10]

1. the parent is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
2. the parent's debt or equity instruments are not traded in a public market;
3. the parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
4. the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.

The consolidated accounts should include all of the parent's subsidiaries, both domestic and foreign: [IAS 27.12]

There is no exemption for a subsidiary whose business is of a different nature from the parent's.

There is no exemption for a subsidiary that operates under severe long-term restrictions impairing the subsidiary's ability to transfer funds to the parent. Such an exemption was included in earlier versions of IAS 27, but in revising IAS 27 in December 2003 the IASB concluded that these restrictions, in themselves, do not preclude control.

There is no exemption for a subsidiary that had previously been consolidated and that is now being held for sale. The parent must continue to consolidate such a subsidiary until it is actually disposed of. However, as a result of an amendment of IAS 27 by IFRS 5 in March 2004, there is an exemption for a subsidiary for which control is intended to be temporary because the subsidiary was acquired and is held exclusively with a view to its subsequent disposal in the near future. For such a subsidiary, if it is highly probable that the sale will be completed within 12 months then the parent should account for its investment in the subsidiary under IFRS 5 as an asset held for sale, rather than consolidate it under IAS 27.

Special purpose entities (SPEs) should be consolidated where the substance of the relationship indicates that the SPE is controlled by the reporting enterprise. This may arise even where the activities of the SPE are predetermined or where the majority of voting or equity are not held by the reporting enterprise. [SIC 12]

Once an investment ceases to fall within the definition of a subsidiary, it should be accounted for as an associate under IAS 28, as a joint venture under IAS 31, or as an investment under IAS 39, as appropriate. [IAS 27.31]

Consolidation Procedures

Intragroup balances, transactions, income, and expenses should be eliminated in full. Intragroup losses may indicate that an impairment loss on the related asset should be recognised. [IAS 27.24-25]

The financial statements of the parent and its subsidiaries used in preparing the consolidated financial statements should all be prepared as of the same reporting date, unless it is impracticable to do so. [IAS 27.26] If it is impracticable a particular subsidiary to prepare its financial statements as of the same date as its parent, adjustments must be made for the effects of significant transactions or events that occur between the dates of the subsidiary's and the parent's financial statements. And in no case may the difference be more than three months. [IAS 27.27]

Consolidated financial statements must be prepared using uniform accounting policies for like transactions and other events in similar circumstances. [IAS 27.28]

Minority interests should be presented in the consolidated statement of financial position within equity, but separate from the parent's shareholders' equity. Minority interests in the profit or loss of the group should also be separately presented. [IAS 27.33]

Where losses applicable to the minority exceed the minority interest in the equity of the relevant subsidiary, the excess, and any further losses attributable to the minority, are charged to the group unless the minority has a binding obligation to, and is able to, make good the losses. Where excess losses have been taken up by the group, if the subsidiary in question subsequently reports profits, all such profits are attributed to the group until the minority's share of losses previously absorbed by the group has been recovered. [IAS 27.35]

Separate Financial Statements of the Parent or Investor in an Associate or Jointly Controlled Entity

In the parent's/investor's individual financial statements, investments in subsidiaries, associates, and jointly controlled entities should be accounted for either: [IAS 27.37]

at cost; or
in accordance with IAS 39.

Such investments may not be accounted for by the equity method in the parent's/investor's separate statements.

Disclosure

Disclosures required in consolidated financial statements: [IAS 27.40]

the nature of the relationship between the parent and a subsidiary when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;
the reasons why the ownership, directly or indirectly through subsidiaries, of more than half of the voting or potential voting power of an investee does not constitute control;
the reporting date of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a reporting date or for a period that is different from that of the parent, and the reason for using a different reporting date or period; and
the nature and extent of any significant restrictions on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans or advances.

Disclosures required in separate financial statements that are prepared for a parent that is permitted not to prepare consolidated financial statements: [IAS 27.41]

the fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name and country of incorporation or residence of the entity whose consolidated financial statements that comply with IFRS have been produced for public use; and the address where those consolidated financial statements are obtainable;
a list of significant investments in subsidiaries, jointly controlled entities, and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and
a description of the method used to account for the foregoing investments.

Disclosures required in the separate financial statements of a parent, investor in a jointly controlled entity, or investor in an associate: [IAS 27.42]

the fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law;

a list of significant investments in subsidiaries, jointly controlled entities, and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and
a description of the method used to account for the foregoing investments.

IAS 28 Investments in Associates (revised 2003)

IAS 28 applies to all investments in which an investor has significant influence but not control or joint control except for investments held by a venture capital organisation, mutual fund, unit trust, and similar entity that (by election or requirement) are accounted for as under IAS 39 at fair value with fair value changes recognised in profit or loss. [IAS 28.1]

Key Definitions [IAS 28.2]

Associate: An enterprise in which an investor has significant influence but not control or joint control.

Significant influence: Power to participate in the financial and operating policy decisions but not control them.

Equity method: A method of accounting by which an equity investment is initially recorded at cost and subsequently adjusted to reflect the investor's share of the net profit or loss of the associate (investee).

Identification of Associates

A holding of 20% or more of the voting power (directly or through subsidiaries) will indicate significant influence unless it can be clearly demonstrated otherwise. If the holding is less than 20%, the investor will be presumed not to have significant influence unless such influence can be clearly demonstrated. [IAS 28.6]

The existence of significant influence by an investor is usually evidenced in one or more of the following ways: [IAS 28.7]

- representation on the board of directors or equivalent governing body of the investee;
- participation in the policy-making process;
- material transactions between the investor and the investee;
- interchange of managerial personnel; or
- provision of essential technical information.

Potential voting rights are a factor to be considered in deciding whether significant influence exists. [IAS 28.9]

Accounting for Associates

In its consolidated financial statements, an investor should use the equity method of accounting for investments in associates, other than in the following three exceptional circumstances:

An investment in an associate that is acquired and held exclusively with a view to its disposal within 12 months from acquisition should be accounted for as held for trading under IAS 39. Under IAS 39, those investments are measured at fair value with fair value changes recognised in profit or loss. [IAS 28.13(a)]

A parent that is exempted from preparing consolidated financial statements by paragraph 10 of IAS 27 may prepare separate financial statements as its primary financial statements. In those separate statements, the investment in the associate may be accounted for by the cost method or under IAS 39. [IAS 28.13(b)]

An investor need not use the equity method if all of the following four conditions are met: [IAS 28.13(c)]

1. the investor is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the investor not applying the equity method;
2. the investor's debt or equity instruments are not traded in a public market;
3. the investor did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
4. the ultimate or any intermediate parent of the investor produces consolidated financial statements available for public use that comply with International Financial Reporting Standards.

Applying the Equity Method of Accounting

Basic principle. Under the equity method of accounting, an equity investment is initially recorded at cost and is subsequently adjusted to reflect the investor's share of the net profit or loss of the associate. [IAS 28.11]

Distributions and other adjustments to carrying amount. Distributions received from the investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be required arising from changes in the investee's equity that have not been included in the income statement (for example, revaluations). [IAS 28.11]

Potential voting rights. Although potential voting rights are considered in deciding whether significant influence exists, the investor's share of profit or loss of the investee and of changes in the investee's equity is determined on the basis of present ownership interests. It should not reflect the possible exercise or conversion of potential voting rights. [IAS 28.12]

Implicit goodwill and fair value adjustments. On acquisition of the investment in an associate, any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate is accounted for like goodwill in accordance with IFRS 3, Business Combinations. Appropriate adjustments to the investor's share of the profits or losses after acquisition are made to account for additional depreciation or amortisation of the associate's depreciable or amortisable assets based on the excess of their fair values over their carrying amounts at the time the investment was acquired. Any goodwill shown as part of the carrying amount of the investment in the associate is no longer amortised but instead tested annually for impairment in accordance with IFRS 3. [IAS 28.23]

Discontinuing the equity method. Use of the equity method should cease from the date that significant influence ceases. The carrying amount of the investment at that date should be regarded as a new cost basis. [IAS 28.18-19]

Transactions with associates. If an associate is accounted for using the equity method, unrealised profits and losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions should be eliminated to the extent of the investor's interest in the associate. However, unrealised losses should not be eliminated to the extent that the transaction provides evidence of an impairment of the asset transferred. [IAS 28.22]

Date of associate's financial statements. In applying the equity method, the investor should use the financial statements of the associate as of the same date as the financial statements of the investor unless it is impracticable to do so. [IAS 28.24] If it is impracticable, the most recent available financial statements of the associate should be used, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends. However, the difference between the reporting date of the associate and that of the investor cannot be longer than three months. [IAS 28.25]

Associate's accounting policies. If the associate uses accounting policies that differ from those of the investor, the associate's financial statements should be adjusted to reflect the investor's accounting policies for the purpose of applying the equity method. [IAS 28.27]

Losses in excess of investment. If an investor's share of losses of an associate equals or exceeds its "interest in the associate", the investor discontinues recognising its share of further losses. The "interest in an associate" is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate. [IAS 28.29] After the investor's interest is reduced to zero, additional losses are recognised by a provision (liability) only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised. [IAS 28.30]

Impairment. The impairment indicators in IAS 39, Financial Instruments: Recognition and Measurement, apply to investments in associates. [IAS 28.31] If impairment is indicated, the amount is calculated by reference to IAS 36, Impairment of Assets. [IAS 28.33] The recoverable amount of an investment in an associate is assessed for each individual associate, unless the associate does not generate cash flows independently. [IAS 28.34]

Separate Financial Statements of the Investor

Equity accounting is required in the separate financial statements of the investor even if consolidated accounts are not required, for example, because the investor has no subsidiaries. But equity accounting is not required where the investor would be exempt from preparing consolidated financial statements under IAS 27. In that circumstance, instead of equity accounting, the parent would account for the investment either (a) at cost or (b) in accordance with IAS 39.

Disclosure

The following disclosures are required: [IAS 28.37]

- fair value of investments in associates for which there are published price quotations;
- summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues, and profit or loss;
- explanations when investments of less than 20% are accounted for by the equity method or when investments of more than 20% are not accounted for by the equity method;
- use of a reporting date of the financial statements of an associate that is different from that of the investor;
- nature and extent of any significant restrictions on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances;
- unrecognised share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate;
- explanation of any associate is not accounted for using the equity method; and
- summarised financial information of associates, either individually or in groups, that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues, and profit or loss.

The following disclosures relating to contingent liabilities are also required: [IAS 28.40]

- Investor's share of the contingent liabilities of an associate incurred jointly with other investors; and
- Contingent liabilities that arise because the investor is severally liable for all or part of the liabilities of the associate.

Presentation

- Equity method investments must be classified as non-current assets. [IAS 28.38]
- The investor's share of the profit or loss of equity method investments, and the carrying amount of those investments, must be separately disclosed. [IAS 28.38]
- The investor's share of any discontinuing operations of such associates is also separately disclosed. [IAS 28.38]
- The investor's share of changes recognised directly in the associate's equity are also recognised directly in equity by the investor, with disclosure in the statement of changes in equity as required by IAS 1 Presentation of Financial Statements. [IAS 28.39]

MODEL ANSWERS TO REINFORCING QUESTIONS

LESSON 1

QUESTION ONE

CAPITAL ACCOUNT

	Abincha Sh.'000'	Chumba Sh.'000'	Bichage Sh.'000'		Abincha Sh.'000'	Bichage Sh.'000'	Chumba Sh.'000'
1996/1997				1997/1998			
Drawings	1,075	870	1,080	Bal b/d	1,500	1,200	1,300
				Interest on capital	225	180	195
Bal c/d	1,800	1,600	1,600	Salaries	600	600	800
				Profit: 1 st	300	240	260
				2 nd	250	250	125
	<u>2,875</u>	<u>2,470</u>	<u>2,680</u>		<u>2,875</u>	<u>2,470</u>	<u>2,680</u>
1997/1998				1997/1998			
Goodwill	-	2,000	1,000	Bal b/d	1,800	1,600	1,600
Drawings	1,222	856	976	Interest on capital	270	240	240
Cash	3096	-	-	Salaries	600	600	800
				Profit: 1 st	288	256	256
Bal c/d	-	3,000	3,400	2 nd	160	160	80
				Goodwill	1,200	1,200	600
	<u>4,318</u>	<u>5,856</u>	<u>5,376</u>	Cash	-	1,800	1,800
					<u>4,318</u>	<u>5,856</u>	<u>5,376</u>
Bal c/d	---	<u>4,545</u>	<u>5,195</u>	1998/1999			
1999/2000				Bal b/d	-	3,00	3,400
CB	-	400	2,800	Interest on capital	-	450	510
CB	-	3,000	1,500	Salaries	-	600	800
Loss on Realization	-	200	100	Profit: 1 st	-	120	60
				2 nd	-	375	425
	<u>---</u>	<u>3,600</u>	<u>4,400</u>		<u>---</u>	<u>4,545</u>	<u>5,195</u>
				1999/2000			
				Bal c/d	-	3,600	4,400
					<u>---</u>	<u>3,600</u>	<u>4,400</u>

DISTRIBUTION OF CASH STATEMENT

(1) **MAXIMUM POSSIBLE LOSS METHOD:**

	Total Sh. '000'	Bichage Sh.'000'	Chomba Sh.'000'
Capital balance	8,000	3,600	4,400
Cash available 15.11.99	<u>(3,200)</u>		
Maximum possible loss	<u>4,800</u>	<u>(3,200)</u>	<u>(1,600)</u>
Cash distributed	<u>3,200</u>	<u>400</u>	<u>2,800</u>
Capital balance	4,800	3,200	1,600
Cash available 30.11.99	<u>(4,500)</u>		
Maximum possible loss	<u>300</u>	<u>(200)</u>	<u>(100)</u>
Cash distributed	<u>4,500</u>	<u>3,000</u>	<u>1,500</u>

(2) SURPLUS CAPITAL METHOD

	Bichage Sh.'000'	Chomba Sh.'000'	Total Sh. '000'
Capital Cash available	3,600	4,400	8,000
Profit sharing ratio	2	1	3
Capital per unit of profit	1,800	4,40	N/A
Capitals in PSR	<u>3,600</u>	<u>1,800</u>	<u>5,400</u>
	<u> </u>	<u>2,600</u>	<u>2,600</u>
Statement of actual distributions 15.11.99:	-	2,600	2,600
Part	400	200	600
Balance	<u>3,000</u>	2,800	3,200
30.11.99: Total	<u>3,400</u>	<u>1,500</u>	<u>4,500</u>
		<u>4,300</u>	<u>7,700</u>

**ABINCHA, BICHAGE AND CHOMBA
P& L APPROPRIATION ACCOUNTS**

	1997		1998		1999	
	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'
Profit for year		4,025		3,950		3,340
Interest on capital						
A	225		270		-	
B	180		240		450	
C	<u>195</u>	<u>600</u>	<u>240</u>	<u>750</u>	<u>510</u>	<u>960</u>
		3,425		3,200		2,380
Salaries						
A	600		600		-	
B	600		600		600	
C	<u>800</u>	<u>1,200</u>	<u>800</u>	<u>2,000</u>	<u>800</u>	<u>1,400</u>
		1,425		1,200		980
Profit 1 st						
A	300		288		-	
B	240		256		375	
C	<u>260</u>	<u>800</u>	<u>256</u>	<u>800</u>	<u>425</u>	<u>800</u>
		625		400		180
2 nd						
A	250		160		-	
B	250		160		120	
C	<u>125</u>	<u>625</u>	<u>80</u>	<u>400</u>	<u>60</u>	<u>180</u>
		<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

QUESTION TWO

(a) **Kioko, Licha and Mengo
Partnership Realisation Account**

	Sh.'000'		Sh.'000'
Land account	2,000	Depreciation accounts:	
Buildings account	3,000	Buildings	990
Plant & machinery account	12,000	Plant and machinery	4,500
Motor vehicles account	4,000	Motor vehicles	3,500
Inventory account	5,200	Trade payables	5,100
Trade Receivables	4,100	Partners capital accounts	
Cash account	1,280	Kioko	400
Additional cash	3,220	Licha	260
Profit on realization:		Mengo	<u>205</u>
Kioko	3,665	Kioko's account:	
Licha	3,665	Debtor	840
Mengo	<u>3,665</u>	Purchaser (Kiligo Ltd) a/c	<u>30,000</u>
	<u>10,995</u>		<u>45,795</u>
	<u>45,795</u>		

(b) **Partnership Capital Accounts**

	Kioko Sh.'000'	Licha Sh.'000'	Mengo Sh.'000'		Kioko Sh.'000'	Licha Sh.'000'	Mengo Sh.'000'
2003				2002			
March 31 drawings	1,440	960	1,200	April 1 Balance b/f	3,000	2,000	4,000
March 31 Realisation				April 1 Current A/cs	3,190	2,000	1,500
A/c: Cars	400	260	205	2003			
March 31 Realisation				March 31 P & L			
A/c: debtor	840			Appropriation A/c:			
Purchaser A/c	10,200	8,400	11,400	Interest on capital	1,800	600	400
				Share of profit	<u>3,600</u>	1,200	1,200
					<u>5,400</u>		
				March 31 Realisation			
				A/c Profit	3,665	3,665	3,665
				Cash book	3,220	<u>1,225</u>	<u>355</u>
	<u>12,880</u>	<u>9,620</u>	<u>12,805</u>		<u>12,880</u>	<u>9,620</u>	<u>12,805</u>

(c) **Kiligo Limited**
Balance Sheet as at 1 April 2003

	Sh.'000'	Sh.'000'
Non-current assets		
Property, plant and equipment at cost:		
Freehold land		5,000
Buildings		4,000
Plant and machinery		<u>10,000</u>
		19,000
Intangible asset: Goodwill cost		<u>2,400</u>
		21,400
Current assets:		
Inventory	5,700	
Trade receivables	2,900	
Cash at bank	<u>4,500</u>	
		13,100
Total assets		<u>34,500</u>
<u>EQUITY AND LIABILITIES</u>		
Share capital: authorized, issued and fully paid:		
Sh.2 million share of Sh.10		20,000
Share premium		<u>10,000</u>
		30,000
Current liabilities:		
Trade payables	<u>4,500</u>	<u>4,500</u>
TOTAL EQUITY AND LIABILITIES		<u>34,500</u>

Purchaser Account

	Sh.		Sh.
Realisation account	30,000	Partners capital accounts:	Shares
		Kioko	10,200
		Licha	8,400
		Mengo	<u>11,400</u>
			760,000
	<u>30,000</u>		<u>30,000</u>
			<u>2,000,000</u>

Partnership Statement of financial position at 31 March 2003 before cash introduced

	Sh.'000'	Sh.'000'
PPM: 21,000 – 8,990		12,010
Current assets:		
Inventory	5,200	
Trade receivables	4,100	
CB (4.5 – 3.22)	<u>1,280</u>	
	10,580	
Current liabilities: Trade payables	<u>(5,100)</u>	<u>5,480</u>
		<u>17,490</u>
Capital: Closing	17,490	
Opening	<u>15,690</u>	1,800
Add drawings		<u>3,600</u>
Net profit for the year		<u>5,400</u>

QUESTION THREE

STATEMENT OF DISTRIBUTION
USING MAXIMUM POSSIBLE LOSS METHOD

	Total Sh.'000'	Emojong Sh.'000'	Barnoi Sh.'000'	Kimani Sh.'000'
Capital a/c	25,000	12,500	7,500	5,000
Current a/c	<u>8,750</u>	<u>5,000</u>	<u>3,750</u>	<u>-</u>
	33,250	17,500	11,250	5,000
Cash available (W1)	<u>(12,925)</u>			
Maximum possible loss	20,825	<u>(8,330)</u>	<u>(8,330)</u>	<u>(4,165)</u>
1 st Distribution	<u>12,925</u>	<u>9,170</u>	<u>2,920</u>	<u>835</u>
capital balance	20,825	8,330	8,330	4,165
cash available	<u>(8,500)</u>			
maximum possible loss	12,325	<u>(4,930)</u>	<u>(4,930)</u>	<u>(2,465)</u>
2 nd Distribution	<u>6,500</u>	<u>3,400</u>	<u>3,400</u>	<u>1,700</u>
capital balance	12,325	4,930	4,930	2,465
cash available	<u>(9,800)</u>			
maximum possible loss	<u>2,125</u>	<u>(1,010)</u>	<u>(1,010)</u>	<u>(505)</u>
3 rd Distribution (W2)	<u>9,800</u>	<u>3,920</u>	<u>3,920</u>	<u>1,960</u>
Total distribution	<u>31,225</u>	<u>16,490</u>	<u>10,240</u>	<u>4,495</u>

(b)

Realisation A/c

	Sh.		Sh.
Goodwill	12,500	CB: June	7,500
Buildings	18,750	July	31,250
Plant & Machinery	9,650	August	8,500
Fixtures	2,125	October	9,750
Motor vehicles	1,000	Discount received	125
Stock	8,000	Capital: E	1,010
Debtors	7,375	B	1,010
Dissolution expenses	<u>250</u>	K	<u>505</u>
	<u>59,650</u>		<u>59,650</u>

CASH & BANK A/C

	Sh.		Sh.
Bal b/d	20	Bal b/d	16,045
Realisation:		Creditors	7,000
June	7,520	Dissolution expenses	250
July	31,250	Loan	2,500
August	8,500	Capital: E	1,010
October	<u>9,750</u>	B	1,010
	<u>57,020</u>	K	<u>505</u>
			<u>31,225</u>
			<u>57,020</u>

(c) CAPITAL A/CS

	E Sh.'000'	B Sh.'000'	K Sh.'000'		E Sh.'000'	B Sh.'000'	K Sh.'000'
Realisation	1,010	1,010	505	Bal b/d	12,500	7,500	5,000
CB	<u>16,490</u>	<u>10,240</u>	<u>4,495</u>	Current a/c	<u>5,000</u>	<u>3,750</u>	-
	17,500	11,250	5,000		17,500	11,250	5,000

W1:

	Sh.	Sh.
Bal b/d		20
June Realisation		7,500
July Realisation		<u>31,250</u>
		38,770
Creditors	7,125	
Discount received	(125)	
Bank overdraft	16,045	
Loan	<u>2,500</u>	<u>25,545</u>
		<u>12,925</u>

W2

	Sh.
Given	9,750
	<u>50</u>
	9,800

QUESTION FOUR

	Apopo & Co Sh'000'	Guserwa & Co Sh'000'	Kandie Sh'000'		Apopo & Co Sh'000'	Guserwa & Co Sh'000'	Kandie Sh'000'
Office Equip.	450	420	150	New firm			
Goodwill	1,500	1,065	240	Office Equip	300	420	150
WIP	1,800	1,050	240	Goodwill	1,800	1,050	150
Debtors	5,250	2,625	225	WIP	1,800	1,050	240
				Debtors	4,200	2,100	180
				Capital:			
				Apopo	300	-	-
				Cheloti	300	-	-
				Chuma	300	-	-
				Guserwa	-	140	-
				Kurgat	-	240	-
				Ochieng	-	60	-
			<u>855</u>	Kandie	-	-	<u>135</u>
	<u>9,000</u>	<u>5,160</u>			<u>9,000</u>	<u>5,160</u>	<u>855</u>

CAPITAL A/C (APOPO CHELOTI & COMPANY)

	Apopo Sh.'000'	Cheloti Sh.'000'	Chuma Sh.'000'		Apopo Sh.'000'	Cheloti Sh.'000'	Chuma Sh.'000'
Realization	300	300	300	Balance.b/d	2,850	2,850	2,850
Cash	2,820	-	-	Current	270	360	120
Bal to new firm	-	4,500	4,500	Cash	-	1,590	1,830
	<u>3,120</u>	<u>4,800</u>	<u>4,800</u>		<u>3,120</u>	<u>4,800</u>	<u>4,800</u>

CAPITAL A/C (GUSERWA & COMPANY)

	Apopo Sh.'000'	Cheloti Sh.'000'	Chuma Sh.'000'		Apopo Sh.'000'	Cheloti Sh.'000'	Chuma Sh.'000'
Realization loss	240	240	60	Balance B/d	1,800	1,800	450
Contra	600	-	-	Current	600	390	60
Bal to new firm	2,250	2,250	750	Contra	-	300	300
	-	-	-	Cash	690	-	-
	<u>3,090</u>	<u>2,490</u>	<u>800</u>		<u>3,090</u>	<u>2,490</u>	<u>800</u>

CAPITAL A/C (Kandie)

	Sh.'000'		Sh.'000'
Realization	135	B/d	900
Cash	15		
Bal to new firm	750		
	<u>900</u>		<u>900</u>

CASHBOOKS (Old Firms)

	Apopo & Co Sh'000'	Guserwa & Co Sh'000'	Kandie Sh'000'		Apopo & Co Sh'000'	Guserwa & Co Sh'000'	Kandie Sh'000'
Bal. B/d	750	300	165	Capital			
Capital:				Apopo	2,820	-	-
Cheloti	1,590	-	-	Kandie	-	-	15
Chuma	1,830	-	-	Creditors	450	360	120
Guserwa	-	690	-	Bal. to New firm	900	630	30
	<u>4,170</u>	<u>990</u>	<u>165</u>		<u>4,170</u>	<u>990</u>	<u>165</u>

Dr**Cr****Journal Entries**

Office Equipment	300	
Goodwill	1,800	
WIP	1,800	
Debtors	4,200	
Cash	900	
Capitals: Cheloti		4,500
Chuma		4,500

To record takeover of assets and capital from Apopo, Cheloti and Company.

Office Equipment	420	
Goodwill	1,050	
WIP	1,050	
Debtors	2,100	
Cash	630	
Capitals: Guserwa		2,250
Kurgat		2,250
Ochieng		750

To record takeover of assets and capital from Guserwa & Company.

	Dr	Cr
Office Equipment	150	
Goodwill	150	
WIP	240	
Debtors	180	
Cash	30	
Capitals: Kandie		750

To record takeover of assets and capital from Kandie.

(b)

	1st Six Months Sh'000'	2nd Six Months Sh'000'	Full Year Sh'000'
Profit after salaries	2,400	2,400	4,800
Add back salaries	300 x 6 <u>1,800</u>	300 x 7 <u>2,100</u>	<u>3,900</u>
Profit before salaries	<u>4,200</u>	<u>4,500</u>	<u>8,700</u>

PROFIT & LOSS APPROPRIATION A/C

	6 Months to 30.09.99		Six Months to 31.03.00		TOTAL	
	Sh'000'	Sh'000'	Sh'000'	Sh'000'	Sh'000'	Sh'000'
Net profit		4,200		4,500		8,700
Salaries: Cheloti						
Chuma	300		300		600	
Guserwa	300		300		600	
Kurgat	300		300		600	
Ochieng	300		300		600	
Kandie	300		300		600	
Maina	-	<u>(1,800)</u>	<u>300</u>	<u>(2,100)</u>	<u>300</u>	<u>(3,900)</u>
		2,400		2,400		4,800
Profit share: Cheloti	720		540		1,260	
Chuma	720		540		1,260	
Guserwa	360		480		840	
Kurgat	360		480		840	
Ochieng	120		120		240	
Kandie	120		180		300	
Maina	-	<u>2,400</u>	<u>60</u>	2,400	60	<u>4,800</u>
		-		-		-

CURRENT A/C

	Cheloti	Chuma	Guserwa	Kurgat	Ochieng	Kandie	Maina		Cheloti	Chuma	Guserwa	Kurgat	Ochieng	Kandie	Maina
Drawings	270	270	270	270	270	270	-	Salaries	300	300	300	300	300	300	-
Drawings	360	360	180	180	60	60	-	Profit	720	720	360	360	120	120	-
Bal c/d	390	390	210	210	90	90	-	share							
	1,020	1,020	660	660	420	420	-		1,020	1,020	660	660	420	420	-
								Bal b/d	390	390	210	210	90	90	-
								Salary	300	300	300	300	300	300	300
								Profit	530	540	480	480	120	180	60
								share	125	125	-	-	-	-	-
								Capital a/c	-	-	-	-	-	-	65
								Bal c/d							
	1,355	1,355	990	990	510	570	425		1,355	1,355	990	990	510	570	425

CAPITAL A/C

	Cheloti	Chuma	Guserwa	Kurgat	Ochieng	Kandie	Maina		Cheloti	Chuma	Guserwa	Kurgat	Ochieng	Kandie	Maina
Cash	1,000	1,000	-	-	-	-	-	Bal b/f	4,500	4,500	2,250	2,250	750	750	-
book	125	125	-	-	-	-	-	Cash	-	-	750	750	-	250	250
Current	3,375	3,375	3,000	3,000	750	1,125	375	book	-	-	-	-	-	-	125
a/c								Current A/c							
Bal c/d															
	4,500	4,500	3,000	3,000	750	1,125	375		4,500	4,500	3,000	3,000	750	1,125	375
Bal c/d	3,375	3,375	3,000	3,000	750	1,125	375	Bal b/d	3,375	3,375	3,000	3,000	750	1,125	375

LESSON 2

QUESTION ONE

Income statement for the year ended 31 March 2003

	Sh. Million
Turnover (net of VAT)	884
Cost of sales	<u>(601)</u>
Gross profit	283
Other incomes	<u>6</u>
	289
Distribution costs	109
Administrative expenses	99
Other expenses	3
Finance costs	27
	<u>(238)</u>
Profit before taxation	51
Income tax expense	<u>(17)</u>
Profit for the period	<u>34</u>

Statement of changes in Equity for the year ended 31 March 2003

	Share Capital Sh. Million	Share Premium Sh. Million	Revaluation Reserve Sh. Million	Retained Earnings Sh. Million	Total Sh. Million
At 1 April 2002	450	188	110	95	843
Net profit				34	34
Excess depreciation			(4)	4	-
At 31 March 2003	<u>450</u>	<u>188</u>	<u>106</u>	<u>133</u>	<u>877</u>

Athi River Cement Limited**Statement of financial position as at 31 March 2003**

	Sh. Million	Total Sh. Million
Non current assets		
Property, plant and equipment (4 and 9)		848
Prepaid operating lease rentals:		60
Deferred expenditure:		<u>15</u>
		923
Current assets:		
Inventories:	186	
Trade and other receivables	194	
Cash and bank balances	<u>5</u>	<u>385</u>
Total Assets		<u>1,308</u>

Equity and liabilities

Capital and reserves		450
Share capital		188
Share premium		106
Revaluation reserve		<u>133</u>
Retained earnings		877
Non current liabilities:		
Borrowings	50	

Finance leases payable	5	
Deferred taxation	<u>151</u>	206
Current liabilities:		
Trade and other payables	160	
Finance leases payable	2	
Borrowings: Bank overdraft	53	
Unclaimed dividends	2	
Compensating tax payable	<u>8</u>	<u>225</u>
<u>Total equity and liabilities</u>		<u><u>1,308</u></u>

Notes to the accounts

Note 1 Accounting policies

These financial statements have been prepared under the historical cost basis of accounting which is modified to accommodate the revaluation of certain properties and in accordance with the applicable IFRSs.

Property plant and equipment is shown at cost or revalued amount less the total accumulated depreciation which is based on the estimated useful life of the assets.

Inventory has been stated at the lower of cost and net realisable value.

Note 2 Profit before tax

The profit before tax has been arrived at after charging the following expenses

	Sh m	Sh.m
Depreciation of PPE		58
Amorisation of Intangibles		7
Directors emoluments - Fees	2	
- Others	<u>12</u>	14
Other staff costs - Wages and salaries	81	
- Social security costs	2	
- Terminal benefits	<u>3</u>	86
Auditors remuneration		2
Loss on disposal of motor vehicles		3

Note 3 Taxation

Corporation tax is based on the adjusted profits for tax purpose at a corporation tax rate of 30%

Note 4 Inventories

Inventories comprise of the following items

	Sh m
Raw materials	48
Work in progress	29
Finished goods	51
Stores and spares	<u>58</u>
	<u>186</u>

QUESTION TWO

REALISATION A/C

	Sh.'000'		Sh.'000'
Net assets taken over (W1)	2,595	Loss on realization	60
Goodwill (Balancing figures)	<u>315</u>	Purchase consideration	<u>2,850</u>
	<u>2,910</u>		<u>2,910</u>

1. Assets – Liabilities (Net assets)	=	Capital + profits - drawings
	=	1,350 + 750 + 495 – 0
	=	2,595

(b) **Maoja Ltd**
Income Statement for the year ended 30.04.01

	Sh.'000'	Sh.'000'
Sales		10,080
Cost of sales		<u>(6,720)</u>
Gross profit		3,360
Distribution expenses	1,092	
Administrative expenses (W2)	651	
Finance costs	<u>90</u>	<u>(1,833)</u>
Profit before tax		1,527
Income tax expense		<u>470</u>
Profit after tax		1,057
Dividends: Interim	300	
Final	<u>210</u>	<u>(510)</u>
		<u>547</u>

Note that final proposed dividends have been included in the income statement because the examiner requires so. Currently IAS 10 requires proposed dividends if declared after the year end to be given as notes to the accounts.

Maoja Ltd
Statement of financial position as at 30.04.01

	Sh.'000'	Sh.'000'
<u>Non current Assets</u>		2,085
Property Plant, and equipment (Note 4)		<u>252</u>
Goodwill		2,337
<u>Current Assets</u>		
Inventory	1,140	
Receivables	1,515	
Cash and bank	<u>405</u>	
Total current Assets		<u>3,060</u>
Total Assets		<u>5,397</u>
<u>Financed by:</u>		
<u>Issued and fully paid share capital</u>		
210,000 ordinary shares of Sh.10 each		2,100
Retained profits		<u>547</u>
Shareholders funds		2,647

Long term liabilities

20% debentures		<u>450</u>
		3,097

Current liabilities

Payables	1,530	
Accruals (debenture interest)	90	
Current tax	470	
Proposed dividends	210	<u>2,300</u>

TOTAL EQUITY AND LIABILITIES5397

W2: Administrative expenses	Sh.'000'
Given	588
Add goodwill amortised (315/5)	<u>63</u>
	651

Notes to the financial statements:

- The above financial statements have been prepared under the historical basis of accounting applicable IFRSs.
- The net profit has been arrived at after charging:

	Sh.'000'
Director's remuneration	60
Depreciation	255
Amortisation of goodwill	63
Staff costs	402
- The tax expense for the year has been arrived at after charging tax at a corporate rate of tax of 30% applicable in Kenya.
- Plant, property and equipment

	Land & Buildings Sh.'000'	Plant & Machinery Sh.'000'	Vehicles Sh.'000'	Total Sh.'000'
<u>Cost/valuation</u>				
Bal as at 01.05.00	-	-	-	-
Additions	<u>900</u>	<u>900</u>	<u>540</u>	<u>2,340</u>
Bal as at 30.04.01	<u>900</u>	<u>900</u>	<u>540</u>	<u>2,340</u>
<u>Depreciation</u>				
Bal as at 01.05.00	-	-	-	-
Charge for the year	<u>30</u>	<u>90</u>	<u>135</u>	<u>255</u>
Bal as at 30.04.01	<u>30</u>	<u>90</u>	<u>135</u>	<u>255</u>
NBV as at 30.04.01	<u>870</u>	<u>810</u>	<u>4050</u>	<u>2,0850</u>

LESSON 3

QUESTION ONE

B LIMITED

In Mombasa Books

Malindi Branch Stock A/C

20X6		Shs	20X7		Shs
July 1	Bal b/d	308,000	Jun 30	Debtors A/C	1,470,000
20X7			Jun 30	Cashbook	168,000
Jun 30	Sundry A/Cs	1,736,000	Jun 30	Sundry A/C: Returns	70,000
			Jun 30	Branch Mark-up A/C Gds stolen	10,500
			Jun 30	P & L A/C: Gds stolen	31,500
			Jun 30	Branch Mark up A/C: Normal loss	7,000
			Jun 30	Branch P&L: cash loss	10,640
			Jun 30	Bal c/d	<u>276,360</u>
		<u>2,044,000</u>			<u>2,044,000</u>
20X7					
July 1	Bal b/d	276,360			

Malindi Branch Mark-Up (Adjustment) Account

20X7		Shs	20X6		Shs
Jun 30	Branch Stock A/C: Returns	17,500	July 1	Balance b/d	77,000
Jun 30	Branch Stock A/C: Gds Stolen	10,500	20X7		
Jun 30	Branch Stock A/C: Normal loss	7,000	Jun 30	Branch Stock A/C	434,000
Jun 30	P & L A/C: Profit	406,910			
Jun 30	Bal c/d	<u>69,090</u>			
		<u>511,000</u>			<u>511,000</u>
			20X7		
			July 1	Balance b/d	69,090

Malindi Branch Debtors Account

20X6		Shs	20X7		Shs
July 1	Balance b/d	276,220	Jun 30	P&L A/C: Bad debts	10,360
20X7			Jun 30	Cashbook	1,568,000
Jun 30	Branch Stock	1,470,000	Jun 30	P&L A/C: Discount	29,960
			Jun 30	Balance c/d	<u>137,900</u>
		<u>1,746,220</u>			<u>1,746,220</u>
20X7					
July 1	Balance b/d	137,900			

QUESTION TWO
D LIMITED

Branch Stock Accounts

20X5		Shs 000	20X6		(a)	(b)	(c)
					Shs 000	Shs 000	Shs 000
Apr 1	Bal b/d	750	Mar 31	CB	1,200	1,200	1,200
20X6			Mar 31	Branch Debtors A/c	4,370	4,370	4,370
Mar 31	Sundry A/cs	6,000	Mar 31	Sundry A/c	300	300	300
Mar 31	Branch Debtors: Goods Returned	80	Mar 31	Branch Stock Adj	60	20	—
			Mar 31	P&L A/c	—	40	60
			Mar 31	Bal c/d	<u>900</u>	<u>900</u>	<u>900</u>
		<u>6,830</u>			<u>6,830</u>	<u>6,830</u>	<u>6,830</u>
20X6							
Apr 1	Balance b/d	900					

Branch Stock Adjustment Account

20X6		(a)	(b)	(c)	20X5		Shs 000
		Shs 000	Shs 000	Shs 000			
Mar 31	Branch Stock A/c	100	100	100	Apr 1	Bal b/d	250
Mar 31	Branch Stock A/c	60	20	—	20X6		
Mar 31	P&L A/c	1,790	1,830	1,850	Mar 31	Branch Stock A/c	2,000
Mar 31	Bal c/d	<u>300</u>	<u>300</u>	<u>300</u>			<u>2,250</u>
		<u>2,250</u>	<u>2,250</u>	<u>2,250</u>	20X6		
					Apr 1	Bal b/d	300

Branch Bank Account

20X5		Shs 000	20X6		Shs 000
Apr 1	Balance b/f	30	Mar 31	P&L: Branch G. Expenses	420
20X6			Mar 31	HO: CB	4,590
Mar 31	Branch Debtors A/c	3,900	Mar 31	Balance c/d	<u>120</u>
	Branch Stock: Cash Sales	<u>1,200</u>			<u>5,130</u>
		<u>5,130</u>			
20X6					
Apr 1	Balance b/d	120			

Goods Sent To Branch Account

20X6		Shs 000	20X6		Shs 000
Mar 31	Branch Stock A/c	200	Mar 31	Branch Stock A/c	4,000
Mat 31	HO Trading A/c	<u>3,800</u>			
		<u>4,000</u>			<u>4,000</u>

Branch Debtors Account

20X5		Shs 000	20X6		Shs 000
Apr 1	Balance b/d	660	Mar 31	P&L A/c: Bad debts	150
20X6			Mar 31	CB	3,900
Mar 31	Branch Stock A/c	4,370	Mar 31	P&L A/c: Discounts Allowed	90
			Mar 31	Branch Stock: Goods Returned	80
			Mar 31	Balance c/d	<u>810</u>
		<u>5,030</u>			<u>5,030</u>
20X6					
Apr 1	Bal b/d	810			

b. INCOME STATEMENT FOR THE YEAR TO 31ST MARCH 20X6

	HO		Branch			Combined		
	Shs 000	(a) Shs 000	(b) Shs 000	(c) Shs 000	(a) Shs 000	(b) Shs 000	(c) Shs 000	
Sales	<u>34,600</u>	<u>5,490</u>	<u>5,490</u>	<u>5,550</u>	<u>40,090</u>	<u>40,090</u>	<u>40,150</u>	
Opening Stock	1,800	500	500	500	2,300	2,300	2,300	
Purchases	<u>27,800</u>	<u>NIL</u>	<u>NIL</u>	<u>NIL</u>	<u>27,800</u>	<u>27,800</u>	<u>27,800</u>	
	29,600	500	500	500	30,100	30,100	30,100	
Goods to branch	<u>(3,800)</u>	<u>3,800</u>	<u>3,800</u>	<u>3,800</u>	—	—	—	
	25,800	4,300	4,300	4,300				
Goods missing	—	—	(40)	—	—	(40)	—	
Closing Stock	<u>(2,200)</u>	<u>(600)</u>	<u>(600)</u>	<u>(600)</u>	<u>(2,800)</u>	<u>(2,800)</u>	<u>(2,800)</u>	
	<u>23,600</u>	<u>3,700</u>	<u>3,660</u>	<u>3,700</u>	<u>27,300</u>	<u>27,260</u>	<u>27,300</u>	
Gross Profit	<u>11,000</u>	<u>1,790</u>	<u>1,830</u>	<u>1,850</u>	<u>12,790</u>	<u>12,830</u>	<u>12,850</u>	
General Expenses	4,100	420	420	420	4,520	4,520	4,520	
Bad Debts	240	150	150	150	390	390	390	
Discount allowed	290	90	90	90	380	380	380	
Loss of (b) Stock	—	—	40	—	—	40	—	
(c) Cash	<u>—</u>	<u>—</u>	<u>—</u>	<u>60</u>	<u>—</u>	<u>—</u>	<u>60</u>	
	<u>4,630</u>	<u>660</u>	<u>700</u>	<u>720</u>	<u>5,290</u>	<u>5,330</u>	<u>5,350</u>	
NET PROFIT	<u>6,370</u>	<u>1,130</u>	<u>1,130</u>	<u>1,130</u>	<u>7,500</u>	<u>7,500</u>	<u>7,500</u>	

QUESTION THREE**K LIMITED****Assumptions:**

1. Non- Current Assets are shown at cost in the trial balances.
2. Taxation is ignored.
3. It is assumed that, in the HO Books, goods sent to branch are credited to purchases and debited to a Goods Sent to Branch Account. This account will be closed off to the Branch Account.

K Limited:**Trading And Profit And Loss Accounts For The Year Ended 31st May 20X2**

	HO	BRANCH	COMBINED
	Shs 000	Shs 000	Shs 000
Sales	<u>1,360</u>	<u>860</u>	<u>2,220</u>
Opening Stock	260	90	350
Purchases/Goods from H.O	<u>1,050</u>	<u>660</u>	<u>1,710</u>
	1,310	750	2,060
Deduct: Goods to Branch	<u>—</u>	<u>—</u>	<u>—</u>
	1,310	750	2,060
Deduct: Closing Stock	<u>320</u>	<u>85</u>	<u>405</u>
Cost of Sales	<u>990</u>	<u>665</u>	<u>1,665</u>
Gross Profit	<u>370</u>	<u>195</u>	<u>565</u>
Salaries and Wages	130	80	210
Staff Commission	8.67	7.68	16.35
Director's Fees	35	—	35
Rent and Rates	10	14	24
Water and Electricity	28	15	43
Advertising	13	2	15
Sundry Expenses	18	5	23
Furniture and Fittings	35	6.25	41.25
Depreciation: Motor Vehicles	63.75	8.75	72.50
Provision for Bad Debts	<u>8.5</u>	<u>0.3</u>	<u>8.8</u>
	<u>349.92</u>	<u>138.98</u>	<u>488.90</u>
Net Profit	<u>20.08</u>	<u>56.02</u>	<u>76.1</u>

Profit And Loss Appropriation Account For The Year Ended 31st May 20X2.

	Shs 000	Shs 000
Net Profit for the year		76.1
After Charging;		
Depreciation	113.75	
Directors' Fees	<u>35</u>	
Deduct:		
Proposed Dividend	140	
Transfer to General Reserve	<u>40</u>	
		<u>180</u>
Retained Profit:		
For the year		(103.9)
Brought forward		<u>150</u>
Carried forward		<u>46.1</u>

STATEMENT OF FINANCIAL POSITIONS AS AT 31ST MAY 20X2

	HEAD OFFICE (NAIROBI)			BRANCH (NAKURU)			COMBINED		
	Shs 000	Shs000	Shs000	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000
FIXED ASSETS									
Furniture and Fittings	280	35	245	50	6.25	43.75	330	41.25	288.75
Motor Vehicles	<u>255</u>	<u>63.75</u>	<u>191.25</u>	<u>35</u>	<u>8.75</u>	<u>26.25</u>	<u>290</u>	<u>72.50</u>	<u>217.50</u>
	<u>535</u>	<u>98.75</u>	436.25	<u>85</u>	<u>15.00</u>	70.00	<u>620</u>	<u>113.75</u>	506.25
Branch Current Account			(69.98)						
CURRENT ASSETS									
Stock		320			85			405	
Debtors		170			6			176	
Less: Provision for Bad Debts		<u>(8.50)</u>			<u>(0.3)</u>			<u>(8.8)</u>	
		161.50			5.7			167.2	
Cash at Bank		216			—			216	
Cash in Transit		<u>50</u>			<u>—</u>			<u>50</u>	
		<u>747.50</u>			<u>90.7</u>			<u>838.2</u>	
CURRENT LIABILITIES									
Bank Overdraft		—			174.5			174.5	
Creditors		47			48			95	
Accruals		40.67			8.18			48.85	
Proposed dividend		<u>140</u>			<u>—</u>			<u>140</u>	
		<u>227.67</u>			<u>230.68</u>	<u>(139.98)</u>		<u>458.35</u>	<u>379.85</u>
			<u>519.83</u>			<u>(69.98)</u>			<u>886.1</u>
SHARE CAPITAL									
Issued and fully paid: 35,000 Ordinary Shares of Shs 20 each			700						700
REVENUE RESERVES									
General Reserve		140						140	
Profit and Loss Account		<u>46.1</u>						<u>46.1</u>	
			<u>186.1</u>						<u>186.1</u>
			<u>886.1</u>						<u>886.1</u>
Head Office Current Account						<u>(69.98)</u>			

Workings:

Branch Current Account

Balance b/d	124	C.I.T.	50
G. to Branch	350	Cashbook	550
P&L	56.02		
Balance c/d	<u>69.98</u>		
	<u>600.00</u>	Balance b/d	<u>600</u>
			69.98

Ho: Current Account

Remittance	600	Balance b/d	124
		G from Nairobi	350
		P&L A/c	56.02
		Balance c/d	<u>69.98</u>
	<u>600</u>		<u>600</u>
Balance b/d	69.98		

Staff Commission Account

	HO	BR		HO	BR
Cashbook	8,000	6,000	Balance b/f	5,000	6,500
Accruals	<u>5,670</u>	<u>8,180</u>	P&L	<u>8,670</u>	<u>7,680</u>
	<u>13,670</u>	<u>14,180</u>		<u>13,670</u>	<u>14,180</u>

Accruals Account

	Shs 000			Shs 000	
	HO	BR		HO	BR
Commission			Directors Fees	35,000	
			Commission: HO	5,670	
			Branch		<u>8,180</u>
Gross profit	370	195			<u>48,850</u>
Less: Pre-commission expenses	<u>297.75</u>	<u>131</u>			
P.b.d.f & Prov.	<u>72.25</u>	<u>64</u>			
12%	8.67	7.68			

QUESTION FOUR**MAINA****Income statement For the Year Ended 31st December 20X9**

	HO BRANCH COMBINED		
	Shs 000	Shs 000	Shs 000
Sales	64,000	41,000	<u>105,000</u>
Goods Sent to Branch	<u>46,200</u>	—	
	<u>110,200</u>	<u>41,000</u>	
Purchases	98,475	—	98,475
Less: Closing Stock	<u>5,000</u>	—	<u>5,000</u>
	93,475	—	93,475
Cost of Processing	<u>2,525</u>	—	<u>2,525</u>
Processed Goods/HO Goods	96,000	44,000	96,000
Less: Closing stock	<u>2,800</u>	<u>7,920</u>	<u>12,000</u>

Cost of Sales	<u>93,200</u>	<u>36,080</u>	<u>84,000</u>
GROSS PROFIT	<u>17,000</u>	<u>4,920</u>	<u>21,000</u>
Selling and general expenses	9,450	1,060	10,510
Loss of stock	—	880	800
Unrealised Pr on Stock	<u>840</u>	<u>—</u>	<u>—</u>
	<u>10,290</u>	<u>1,940</u>	<u>11,310</u>
NET PROFIT	<u>6,710</u>	<u>2,980</u>	<u>9,690</u>

STATEMENT OF FINANCIAL POSITIONS AS AT 31ST DECEMBER 20X9

	HO Shs 000	BRANCH Shs 000	COMBINED Shs 000
Branch current a/c	16,055		
Less: Prov for unrealised Pr St	<u>640</u>		
	15,415		
CURRENT ASSETS:			
Stock	9,800	7,040	16,200
Debtors	15,480	5,680	21,160
Cash at bank and in transit	<u>11,815</u>	<u>3,875</u>	<u>15,690</u>
	<u>37,095</u>	<u>16,595</u>	<u>53,050</u>
CURRENT LIABILITIES:			
Creditors	<u>30,070</u>	<u>540</u>	<u>30,610</u>
	<u>7,025</u>	<u>16,055</u>	<u>22,440</u>
	<u>22,440</u>	<u>16,055</u>	<u>22,440</u>
CAPITAL:			
Opening balance	15,500	—	15,500
HO a/c	—	16,055	—
Add: Profit	<u>9,690</u>		<u>9,690</u>
	25,190		25,190
Deduct: Drawings	<u>2,750</u>		<u>2,750</u>
	<u>22,440</u>	<u>16,055</u>	<u>22,440</u>
Workings			
Branch	41,000 X	15/125 =	4,920
HO:	46,200 X	10/110 =	4,200
	64,000 X	25/125 =	12,800
Goods Shortage	1,000 X	110/125 =	880
UPS: (7,920 - 880)	X	10/110 =	640
	2,200 X	10/110 =	200
			BR. Goods in Transit

Ho Books: Branch Current Account

Balance b/f	19,490	Goods In Transit	2,200
P&L	2,980	Cash In Transit	4,215
	<u>—</u>	c/d	<u>16,055</u>
	<u>22,470</u>		<u>22,470</u>

Goods in Transit

Branch	2,200
--------	-------

Cash In Transit

Branch	4,215
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Branch Books: Ho Account

Balance b/f	13,075
P&L	<u>2,980</u>
	<u>16,050</u>

QUESTION FIVE

San Francisco

Trial balance as at 31 December 19X7

	\$	\$	Rate	\$	\$
	Dr	Cr		Dr	Cr
Leasehold premises	40,000		2.2	18,182	
Amortisation of lease		8,000	2.2		5,455
Amortisation for the year: (B/S)		4,000			
(P/L)	4,000		1.8	2,222	
Delivery vans, at cost	10,000		2.2	4,545	
Provision for depreciation on vans		5,000	2.2		3,409
Depreciation for the year: (B/S)		2,500			
(P/L)	2,500		1.8	1,389	
Opening stock	12,460		1.8	6,922	
Debtors	6,293		1.6	3,933	
Sales		116,308	1.8		64,616
Purchases	21,800		1.8	12,111	
Goods from London	38,620		Actual	20,700	
Administration expenses	3,142		1.8	2,1	
Administration expenses accrued: (P/L)	760				
(B/S)		760	1.6		475
Salaries and wages	23,500		1.8	13,056	
London current account (W)		49,520	Actual		24,900
Directors' remuneration	5,120		1.6	3,200	
Selling and delivery costs	8,940		1.8	4,967	
Cash at bank	13,789		1.6	8,674	
Creditors		4,926	1.6		3,079
Closing stock: local (P/L)		6,060	1.8		3,367
(B/S)	6,060		1.6	3,788	
London (P/L)		9,180	1.7		5,400
(B/S)	9,180		1.7	<u>5,400</u>	
				111,257	110,701
Profit on exchange					<u>556</u>
	<u>206,254</u>	<u>206,254</u>		<u>111,257</u>	<u>111,257</u>

b) Trading and profit and loss accounts for the year ended 31 December 19X7

	London	San Francisco	Combined
	£	£	£
Sales	78,318	64,616	142,934

Transfers to San Francisco	21,600		
	<u>99,918</u>	<u>64,616</u>	<u>142,934</u>
Opening stocks	8,620	6,922	15,042
Purchases	70,066	12,111	82,177
Transfers from London		<u>20,700</u>	
	78,686	39,733	97,219
Closing stocks	<u>12,470</u>	<u>8,767</u>	<u>21,087</u>
	<u>66,216</u>	<u>30,966</u>	<u>76,132</u>
Gross profit	<u>£ 33,702</u>	<u>£33,650</u>	<u>£66,802</u>
Administration expenses	3,186	2,168	5,354
Salaries and wages	9,420	13,056	22,476
Directors' remuneration	4,800	3,200	8,000
Selling and delivery costs	5,485	4,967	10,452
Amortisation of lease	1,000	2,222	3,222
Depreciation on vans	3,000	1,389	4,389
Provision for unrealized profits	<u>550</u>		
	<u>27,441</u>	<u>27,002</u>	<u>53,893</u>
Net profit	6,261	6,648	12,909
Profit on exchange		<u>556</u>	<u>556</u>
	<u>£6,261</u>	<u>£7,204</u>	<u>£13,465</u>

Statement of financial position as at 31 December 19X7

	£	£	£
Non Current assets			
Leasehold premises		33,182	
Less: Amortisation		<u>13,455</u>	19,727
Motor vehicles		16,545	
Less: Depreciation		<u>12,409</u>	<u>4,136</u>
			23,863
Current assets			
Inventory		21,508	
Receivables		7,802	
Cash at bank		<u>15,597</u>	
		44,907	
Current liabilities			
Payables	13,830		
Accrued charges	<u>1,275</u>	<u>15,105</u>	<u>29,802</u>
			<u>£53,665</u>
Representing:			
Share capital			20,000
Profit and loss account			<u>33,665</u>
			<u>£53,665</u>

Workings:

San Francisco current account

	£		£
Balance b/d	22,600	Goods in transit account	900
Salaries and wages	<u>3,200</u>	Balance c/d	<u>24,900</u>
	<u>£25,800</u>		<u>£25,800</u>
Balance b/d	24,900		
Profit and loss account	<u>7,204</u>		
	32,104		

London current account

	\$		\$
Balance c/d	49,520	Balance b/d	44,400
	<u>49,520</u>	Directors remuneration (at \$1.60 to the £)	<u>5,120</u>
			<u>\$49,520</u>

3. Provision for unrealized profit

	£	
Balance brought forward	500	
Provision for the year:		
On stocks at San Francisco:		
$\$9,180 @ 1.70 = \text{£}5,400 \left(\times \frac{20}{120} \right) = 900$		
On goods in transit: $\text{£}900 \left(\times \frac{20}{120} \right) = 150$	<u>1,050</u>	
Increase in provision	<u>£550</u>	

Closing stocks for combined trading account

	£	£
London		12,470
San Francisco: from London	5,400	
Less: provision	<u>900</u>	
	4,500	
Local	<u>3,367</u>	7,867
Goods in transit	900	
Less: provision	<u>150</u>	<u>750</u>
		<u>£21,087</u>

Closing stocks for combined statement of financial position:

		12,470
London		
San Francisco: from London	5,400	
Less: provision	<u>900</u>	
	4,500	
Local	<u>3,788</u>	8,288
Goods in transit	900	
Less: provision	<u>150</u>	<u>750</u>
		<u>£21,508</u>

LESSON 4

QUESTION ONE

LOITA LTD & SUBSIDIARY

CONSOLIDATED INCOME STATEMENT FOR THE YEAR 30.09.99

	Loita Sh.'000'	Leserni Sh.'000'	Group Sh.'000'
Turnover	642,500	372,000	853,500
Cost of sales			
Opening stock	51,250	28,240	
Purchases	<u>320,650</u>	<u>187,500</u>	
	371,900	215,740	
Less closing stock	<u>51,300</u>	<u>29,740</u>	
	<u>(320,600)</u>	<u>(186,000)</u>	<u>(392,100)</u>
Gross profit	321,900	186,000	461,400
Distribution costs	(112,350)	(64,600)	(160,800)
Administration costs	(94,550)	(36,400)	(121,850)
Goodwill amortised	-	-	(1,500)
Operating profit	115,000	85,000	177,250
Finance costs: debenture interest	<u>(10,000)</u>	<u>(-)</u>	<u>(10,000)</u>
	105,000	85,000	167,250
Investment income: dividends	<u>18,000</u>	-	-
Profit before tax	123,500	85,000	167,250
Tax	<u>(31,000)</u>	<u>(25,000)</u>	<u>(49,750)</u>
Profit after tax	92,000	60,000	117,500
Less minority interest	-	-	(18,000)
	92,000	60,000	99,500
Dividends: Interim paid	(20,000)	(20,000)	(20,000)
Final proposed	<u>(40,000)</u>	<u>(20,000)</u>	<u>(40,000)</u>
Retained profit: Year	32,000	20,000	39,500
B/f	<u>64,950</u>	<u>31,800</u>	<u>64,950</u>
C/f	<u>96,950</u>	<u>51,800</u>	<u>104,450</u>

LOITA & SUBSIDIARY
CONSOLIDATED BALANCESHEET AT 30.09.99

	Loita Sh.'000'	Leserin Sh.'000'	Group Sh.'000'
<u>NON CURRENT ASSETS</u>			
Property,plant and equipment(Note 1)	141,920	62,800	204,720
Intangibles: Goodwill	-	-	8,500
Investments	<u>56080</u>	<u>-</u>	<u>-</u>
	198,000	62,800	213,220
<u>CURRENT ASSETS</u>			
Inventories	51,300	29,740	81,040
Debtors	53,520	31,260	75,780
Dividend receivable	12,000	-	-
Cash at bank	6,830	8,200	15,030
Cash in transit	<u>-</u>	<u>-</u>	<u>3,000</u>
Total Current Assets	<u>123,650</u>	<u>69,200</u>	<u>174,850</u>
Total Assets	<u>321650</u>	<u>132000</u>	<u>388070</u>
<u>Financed by</u>			
Ordinary share capital	100,000	40,000	100,000
Retained profit	<u>96,950</u>	<u>51,800</u>	<u>104,450</u>
Shareholder's funds	196,950	91,800	204,450
Minority Interest	<u>-</u>	<u>-</u>	<u>36,720</u>
	196,950	91,800	241,170
Non Current Liabilities			
20% Debenture stock	<u>50,000</u>	<u>-</u>	<u>50,000</u>
	246,950	91,800	291,170
<u>CURRENT LIABILITIES</u>			
Creditors	31,800	18,100	43900
Tax payable	2,900	2,100	5000
Proposed dividends	40,000	20,000	20,000
Dividend to Minority interest	-	-	8,000
	74,700	40,200	96,900
<u>TOTAL EQUITY AND LIABILITIES</u>	<u>321650</u>	<u>132000</u>	<u>388070</u>

Workings1. **Dividends**

	Sh.'000'
Holding: Interim (paid)	20,000
Final (proposed) (40% x 100,000)	<u>40,000</u>
Subsidiary: Interim (paid)	<u>60,000</u>
Final proposed (50% x 40,000)	20,000
Preacquisition (3/12 x 60% x 40,000)	<u>20,000</u>
Post-acquisition (9/12 x 60 x 40,000)	40,000
	6,000 To Cost of control
	18,000 to Profit & Loss
	<u>8,441</u>

2. Cost of Control			
	Sh.'000'		Sh.'000'
Investment in subsidiary	62,080	Pre-acquisition dividend	6,000
		Ordinary share capital	24,000
		Profit & Loss	22,080
		Goodwill written off 1,500	
		C/d 8,500	10,000
	<u>62,080</u>		<u>62,080</u>

3. Profit and Loss Working			
	Sh.'000'		Sh.'000'
Goodwill written off	1,500	Loita	96,950
Bal c/	<u>104,450</u>	Leserni	<u>9,000</u>
	<u>105,590</u>		<u>105,590</u>

4. Minority Interest			
	Sh.'000'		Sh.'000'
Bal c/d	<u>36,720</u>	Ordinary share capital	16,000
	<u>36,720</u>	Profit and loss	<u>20,720</u>
			<u>36,720</u>

The post-acquisition reserves in Leserni is calculated as $(20,000 \times 9/12 \times 60\%)$

5. Reserves (Subsidiary)		Sh.'000'
Reserves b/f		31,800
Pre-acquisition reserves for year $(3/12 \times 20,000)$		<u>5,000</u>
Total pre-acquisition reserves		36,800
Group share (60%) to COC		22,080

6.		Sales Sh.'000'	Cost of sales Sh.'000'	
Loita		642,500	320,600	
Leserni	$(372,000 \times 9/12)$	<u>279,000</u>	<u>139,500</u>	$(186,000 \times 9/12)$
		<u>921,500</u>	<u>460,100</u>	

	Loita Sh.'000'	Leserni (9 months) Sh.'000'	Total Sh.'000'
Distribution costs	112,350	48,450	160,800
Administrative expenses	94,550	27,300	121,850
Tax	31,000	18,750	49,750

PROPERTY, PLANT AND EQUIPMENT

	LOTA	LESERIN	GROUP
Land and Buildings	60200	38100	98300
Motor vehicles	11270	4400	15670
Plant and Machinery	<u>70450</u>	<u>20300</u>	<u>90750</u>
TOTAL (NBV)	<u>141920</u>	<u>62800</u>	<u>204720</u>

NOTE 2**WORKINGS FOR INVESTMENTS**

	shs
Investment	62,080
Less: Pre acquisition dividend	<u>6,000</u>

QUESTION TWO**WORKINGS**1. UPOS, UPCS, UPFA

	B sells to A	A Sells to B	Trading	UPOs	UPCs	UPFA
	%	%	Sh.'000'	Sh.'000'	Sh.'000'	Sh.'000'
Cost	75.36	100	7,008.48	406.94	542.59	2,000
Profit	<u>24.64</u>	<u>20</u>	<u>2,291.52</u>	<u>133.06</u>	<u>177.41</u>	<u>400</u>
Selling price	<u>100</u>	<u>120</u>	<u>9,300</u>	<u>540</u>	<u>720</u>	<u>2,4000</u>

ADDIS, BUNYALA & CHANIA
PROFIT & LOSS A/C FOR THE YEAR ENDED 30.11.00

	Addis Sh.'000'	Bunyala Sh.'000'	Chania Sh.'000'	Group Sh.'000'
Sales	84,000	66,000	48,000	176,700
<u>Cost of sales</u>				
Opening stock	3,824	3,757	2,822	
Purchases	50,862	49,867	38,430	
Depreciation	-	240	-	
	54,686	53,864	41,252	
Less closing stock	<u>(50,400)</u>	<u>(4,124)</u>	<u>(2,452)</u>	<u>(119,944.35)</u>
Gross profit	33,600	16,260	9,200	56,77.65
Distribution costs	(13,440)	(8,050)	(9,600)	
Administration costs	<u>(8,400)</u>	<u>(3,950)</u>	<u>(6,400)</u>	<u>(17,650)</u>
Operating profit	11,760	4,260	(6,800)	10,415.65
Dividend income: Bunyala ord.	360	-	-	-
Pref.	1,000	-	-	-
Chania ord.	<u>67.5</u>	-	-	-
Profit before tax	13,187.5	4,260	6,800	10,415.65
Tax: Current	(2,140)	(1,050)	-	(3,190)
Deferred	<u>(1,420)</u>	<u>(300)</u>	<u>2,040</u>	<u>(190)</u>
	<u>(3,560)</u>	<u>(1,350)</u>	<u>2,040</u>	<u>(3,380)</u>
Profit after tax	9,627.5	2,910	(4,760)	7,035.65
Less MI	-	-	-	<u>(486.87)</u>
Profit attributable to ordinary shareholders	9,627.5	2,910	7,522.52	7,522.52
Dividends: Pref.	-	900	-	-
Ord: Interim	(3,000)	(500)	-	(3,000)
Final	<u>4,500</u>	<u>(750)</u>	<u>(150)</u>	<u>(4,500)</u>
Retained profit: Year	2,127.5	760	(4,910)	22.52
B/f	<u>18,300</u>	<u>12,650</u>	<u>9,200</u>	<u>19,965.56</u>
C/f	<u>20,427.5</u>	<u>13,410</u>	<u>4,290</u>	<u>19,988.08</u>

RECONCILIATION OF RETAINED PROFIT

	B/f Sh.'000'	Year Sh.'000'	C/f Sh.'000'
<u>Addis:</u>	18,300	2,127.5	20,247.5
UPFA	(400)	-	(400)
Goodwill amortised	<u>(1,500)</u>	<u>(500)</u>	<u>(2,000)</u>
	<u>16,400</u>	<u>1,627.5</u>	<u>18,027.5</u>
<u>Bunyala</u>	12,650	760	13,410
Less pre-acquisition	(8,100)	-	(8,100)
UPCS	-	(177.41)	(177.41)
UPOS	(133.06)	133.06	-
Depreciation adjustment	<u>40</u>	<u>40</u>	<u>80</u>
	<u>445,694</u>	<u>755.65</u>	5,212.59
Group share 80%	<u>3,565.56</u>	<u>604.52</u>	<u>4,170.08</u>
<u>Chania</u>	9,200	(4,910)	4,290
Less pre-acquisition	<u>(9,200)</u>	<u>1,227.5</u>	<u>(7,972.5)</u>
	-	<u>(3,682.5)</u>	<u>(3,682.5)</u>
Group share 60%	-	<u>(2,209.5)</u>	<u>(2,209.5)</u>
Total (A+B+C)	<u>19,965.56</u>	<u>22.52</u>	<u>19,988.08</u>

MINORITY INTEREST

	Bunyala	Chania
PAT	2,910	(4,760)
Pre-acquisition	-	1,190
Depreciation adjustment	40	-
UPCS	(177.41)	-
UPOS	<u>133.06</u>	=
	<u>2,905.65</u>	<u>(3,570)</u>
	Pref 900	Ord 2005.65
	Group 40%	MI 20%
	360	401.13
	MI 60%	Group 80%
	540	1,604.52
		Group 60%
		(2,042)
		MI 40%
		(1,428)

$$\text{Total MI} = 540 + 401.13 + (1,428) + 486.87$$

$$\text{Group sales} = 84,000 + 66,000 + (9/12 \times 48,000) - 9,300 =$$

↑ ↑ ↑ ↑
 Holding Subsidiary Subsidiary Intergroup

$$\text{Group cost of sales} = 50,400 + 49,740 + (9/12 \times 38,800) - 9,300 - 40 - 133.06 + 177.41$$

↑ ↑ ↑ ↑ ↑ ↑ ↑
 Addis Bunyala Chania Intergroup Dep'n adj. UPOS UPCS

QUESTION THREE**INVESTMENT IN CET BY BEM**

Bal b/d	Sh'000'	4,00	Sh'000'	Loan stock	Sh'000'	5,000
To COC A/C		<u>1,000</u>				
		<u>5,000</u>				<u>5,000</u>

LOAN STOCK CET

	Sh'000'	Sh'000'	Sh'000'
Investment in loan stock	5,000	Balance b/d	10,000
To CBS	<u>5,000</u>		<u>10,000</u>
	<u>10,000</u>		<u>10,000</u>

INVESTMENT IN BEM BY A/C

	Sh'000'	Sh'000'	Sh'000'
Bal b/d	80,000	Loan stock of BEM	10,000
To COC	<u>2,000</u>		<u>10,000</u>
	<u>10,000</u>		<u>10,000</u>

LOAN STOCK OF BEM

	Sh'000'	Sh'000'	Sh'000'
Investment in loan stock	10,000	Loan stock	20,000
To CBS	<u>10,000</u>		<u>20,000</u>
	<u>20,000</u>		<u>20,000</u>

Control structure	BEM %	CET %
Parent: Direct	75	-
Indirect	-	60
MI Direct	25	20
Indirect	<u>-</u>	<u>20</u>
	<u>100</u>	<u>100</u>

COST OF CONTROL

	Sh'000'	Sh'000'
A/c: Investment in BEM	70,000	OSC: BEM
BEM: Investment in CET	27,000	Profit & Loss BEM
		OSC: CET
		Profit & Loss CET
		Inv. In BEM
		Inv. In CET
		Goodwill: Written off
		C/d
	<u>97,000</u>	<u>97,000</u>

PROFIT AND LOSS WORKING

	Sh'000'	Sh'000'
BEM	5,250	AC
CET	4,200	
Goodwill written off	3,600	
CBS	<u>2,300</u>	
	<u>15,350</u>	<u>15,350</u>

	M. I		
	Sh'000'		Sh'000'
Investment in CET	9,000	OSC: BEM	7,500
CBS	22,450	Profit & Loss BEM	10,750
		OSC: CET	4,000
		Profit & Loss CET	<u>9,200</u>
	<u>31,450</u>		<u>31,450</u>

AC LTD & SUBSIDIARIES
STATEMENT OF FINANCIAL POSITION AS AT 31.05.2000
Sh'000'

NON CURRENT ASSETS

Profit, Property and Equipment	136,800
Goodwill	<u>6,400</u>
	143,200

CURRENT ASSETS

	36,800	
Debtors	<u>43,300</u>	
Cash		<u>80,100</u>
Total Current Assets		<u>223,300</u>

Financed by:

		100,000
Share capital		<u>2,300</u>
Retained earnings		102,300
Shareholders fund		<u>22,450</u>
Minority interest		124,750
Total shareholders funds		

NON CURRENT LIABILITIES

12% loan stock:	30,000	
AC	10,000	
BEM	<u>5,000</u>	45,000
CET		

CURRENT LIABILITIES

Creditors	25,000	
Tax payable	4,500	
Bank overdraft	9,300	
Dividend to MI	4,750	
Proposed dividends	<u>10,000</u>	
		<u>53,550</u>
		<u>223,300</u>

QUESTION FOUR

WORKINGS

- Determination of group structure
Control in Lenga = $\frac{4,500}{15,000} \times 100\% = 30\%$ (Associate)

$$\text{Control in Tera} = \frac{15,000}{20,000} \times 100\% = 75\%(\text{Subsidiary})$$

2. Unrealized profit on stock

	%	Sh.'000'
Buying price	100	32,000
Margin	<u>25</u>	<u>8,000</u>
Selling price	<u>125</u>	<u>40,000</u>
Treatment: Dr Holding co.	75% x 8,000 = 6,000	
Dr MI	25% x 8,000 = 2,000	
Cr group stock		8,000

3. Premium on acquisition of associate.

	Sh.'000'	Sh.'000'
Cost of investment		152,000
Share of associate equity		
Ordinary share capital	300,000	
Share premium	24,000	
Retained (218 – 102)	116,000	
30% x 440,000		<u>132,000</u>
		<u>20,000</u>
Amortization per annum	$\frac{20,000}{2} = 4,000$	

INVESTMENT IN ASSOCIATE

	Sh.'000'		Sh.'000'
Cost of investment	152,000	Premium Amortization	4,000
Share of post acquisition profit	21,600	Balance to CBS	
	<u>173,600</u>		<u>173,600</u>

4. Analysis of Tera

COST OF CONTROL

	Sh.'000'		Sh.'000'
Cost of investment	716,000	Share of Equity	
		OSC (75% x 400,000)	300,000
		Capital reserve (75% x 56,000)	42,000
		Profits 75% (288 – 128)	120,000
		¼ - 1/7) 75% x 3/12 (128 – 40)	<u>16,500</u>
		Pre-acquisition dividend (75% x 40 x ¾)	7,500
		Revaluation reserve (75% x 240,000)	180,000
		Goodwill	<u>50,000</u>
	<u>716,000</u>		<u>716,000</u>

$$\text{Goodwill amortization C/D} = \frac{50,000}{5} \times 9/12 = 7,500$$

5. **GROUP RETAINED EARNINGS A/C**

	Sh.'000'		Sh.'000'
Cost of control (120,000 + 16,500)	136,500	Balance b/d (Mega) (786 – 200)	586,000
MI (25% x 248,000)	62,000	Tera Ltd (288 – 10% x 400)	248,000
UPCS	6,000	Associate (investment)	
Depreciation adjustment (180,000 x 10%)	18,000	Share of post acquisition	21,600
Goodwill amortization	7,500	Share of dividends: subsidiary (75% x 40,000 x 9/12)	22,500
Premium	400	Associate (30% x 30,000)	9,000
To CBS	653,100		
	<u>887,100</u>		<u>887,100</u>

6. **MINORITY INTEREST**

	Sh.'000'		Sh.'000'
UPCS	2,000	OSC (25% x 400)	100,000
To CBS	174,000	Capital Reserves (25% x 56)	14,000
	<u>176,000</u>	Retained profit 25% (288 – 40)	<u>62,000</u>
			<u>176,000</u>

7. **PLANT & MACHINERY**

Mega (1,375,000 – 521,800)	853,200
Tera (350,600 – 124,600)	225,600
Share of revaluation (75% x 240)	180,000
Depreciation in revaluation	<u>(18,000)</u>
	<u>1,240,600</u>

MEGA LTD & SUBSIDIARY
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31.03.02

	Sh.'000'	Sh.'000'
<u>Non Current Assets</u>		
Property (720 + 200)		920,000
Plant & Machinery		1,240,600
Goodwill		42,500
Investment in associate		<u>169,600</u>
		2,372,700
<u>Current Assets</u>		
Stock (380 + 360.6 – 8)		
Debtors (374.8 + 125)	732,600	
Dividends Receivable	499,800	
Cash in Transit	9,000	
Bank	12,000	
	<u>40,000</u>	
		<u>1,293,400</u>
		<u>366,6100</u>

Financed by:	
Share capital	1,000,000
Share premium	200,000
Capital Reserve	300,000
Retained Earnings	<u>653,100</u>
	215,3100
MI: Non current liability	<u>174,000</u>
	2,327,100
<u>Current liabilities</u>	
Creditors 590 + 152)	742,000
Tax (190 + 103)	293,000
Dividends proposed (Mega) (20% x 2M)	200,000
MI share dividend (25% x 40,000)	10,000
Bank overdraft	<u>94,000</u>
	1,339,000
<u>TOTAL EQUITY AND LIABILITIES</u>	<u>366,6100</u>

QUESTION FIVE

EMPIRE LTD
CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 30.6.1998

	Sh.'000'	Sh.'000'
Operating Activities		
Profit before tax	10,950	
Extraordinary item	<u>150</u>	
	11,100	
Adjustments for non cash items:		
Depreciation of PPE	3,600	
Profit of associate	<u>(450)</u>	
	14,250	
Adjustments for working capital items		
Increase in stock	(10,500)	
Increase in debtors	(3,150)	
Increase in creditors	<u>1,350</u>	
Cash generated from operations	1,950	
Tax paid (W3)	<u>(3,000)</u>	
Net cash outflow from operating activities		(1,050)
Investing Activities		
Payments to acquire fixed assets (W1)	(11,550)	
Proceeds on disposal of total fixed assets	2,700	
Proceeds on disposal of investments (W2)	<u>4,200</u>	
Net cash outflow from investing activities		(4,650)
Financing Activities		
Issue of ordinary share capital	1,500	
Redemption of loan capital	(7,200)	
Short term borrowing obtained	15,900	
Equity dividend paid	<u>(4,200)</u>	
Net cash inflow from financing activities		<u>6000</u>
Increase in cash during the period		

Cash and cash equivalent b/d	300
Cash and cash equivalent c/d	<u>900</u>
	<u>1,200</u>

WORKINGS

1.	Fixed Asset Account	
	Sh.'000'	Sh.'000'
	Balance b.d	Disposals
	45,600	2,700
	Cash book: additions	Depreciation
	11,550	3,600
	<u>57,150</u>	Balance c/d
		<u>50,850</u>
		<u>57,150</u>
2.	Investment Account	
	Sh.'000'	Sh.'000'
	Bal. B/d	Investment revaluation reserve
	37,350	11,700
	Investment revaluation reserve	Cash book: disposal
	900	4,200
	<u>38,250</u>	Bal. C/d
		<u>22,350</u>
		<u>38,250</u>
3.	Tax account	
	Sh.'000'	Sh.'000'
	Cash book	Bal b/d
	3,000	1,950
	Bal c/d	Profit & Loss
	<u>1,200</u>	<u>2,250</u>
	<u>4,200</u>	<u>4,200</u>

LESSON 5**QUESTION ONE**

**CHEGE: STATEMENT OF AFFAIRS
AS AT 30TH JUNE 20X1**

Gross Liabilities Shs '000'	Liabilities	Shs '000'	Assets	Shs '000'
1,636	Unsecured creditors	1,636	Cash at bank	90
	Creditors fully secured:		Stock (Cost Shs 400,000)	300
800	Loan	800	Investment in IV Ltd.	20
	Value of shop	1,400	Trade debtors	350
	Surplus per contra	<u>600</u>	Motor car	20
50	Preferential Creditors (deducted per contra)	<u>50</u>	Gold watch	50
			Surplus from creditors F.S	600
				1,430
				<u>(50)</u>
				1,380
			Deficiency: as per Deficiency Account	<u>256</u>
<u>2,486</u>		<u>1,635</u>		<u>1,636</u>

Deficiency Account	
	Shs '000'
Excess of Assets over liabilities	
As at 30 the June 20X0:	
Business	600
Personal	<u>104</u>
	704
Profit for the year	
Ended 31 st Dec 1991	200
Estimated profit on Realisation:	
Freehold	
Shop building	200
Deficiency as per Statement	<u>256</u>
	<u>1,360</u>
Drawings: Year	
Ended 30 th June 20X0	180
Estimated loss on	
Realization:	
Stock	100
Investment	980
Debtors	<u>100</u>
	1,180
	<u>1,360</u>

QUESTION TWO

Wanja and Juma						
Statement of Affairs						
As At 1st November 20X1						
Gross Liabilities	Liabilities (as stated and estimated by debtors)	Expected to Rank	Assets (as stated and estimated by Debtors)	Estimated to Produce		
Shs.		Shs.		Shs.	Shs.	
1,300,000	Unsecured creditors		Cash in Bank			35,000
230,000	Creditors Partly secured	1,300,000	Cash in Hand			12,000
	Estimated value of security	230,000	(Cost Shs 100,000)			85,000
		<u>200,000</u>	Fixtures			10,000
		30,000	Debtors: Good			140,000
			Doubtful	50,000		
			Bad	40,000		
14,000	Preferential Creditors		Estimated to Produce	<u>10,000</u>		<u>10,000</u>
	Deducted contra	<u>14,000</u>				292,000
			Preferential Creditors			<u>(14,000)</u>
						278,000
			Deficiency as per Deficiency Account			<u>1,052,000</u>
<u>1,544,000</u>		<u>1,330,000</u>				<u>1,330,000</u>

Included in unsecured creditors is a deferred creditor Mr. Kuria in the amount of Shs.100,000. This amount represents a loan from Mr. Kuria, the interest of which varies with the firm's profits.

Deficiency Account

	Shs.		Shs.
Excess of assets over liabilities As at 1 st January 20X0	216,000	Trading loss from carrying on Business from 1 st January 20X0	784,400
		Drawings by partners during this period	298,600
			1,083,000
		Estimated Loss on Realisation:	
		Stock	15,000
		Fixtures	90,000
		Debtors	<u>80,000</u>
Deficiency as per Statement of Affairs	<u>1,052,000</u>		<u>185,000</u>
	<u>1,268,000</u>		<u>1,268,000</u>

QUESTION THREE

Rucha and Mambo

Statement of Affairs

	Ruma Sh '000'	Rucha Sh '000'	Mambo Sh '000'		Ruma Sh '000'	Rucha Sh '000'	Mambo Sh '000'
Unsecured Creditors	<u>8,500</u>	<u>300</u>	1,300	Plant	400	-	-
Creditors fully secured:	2,250	1,600		Furniture etc	200	400	550
Deduct value of freehold:	<u>(3,250)</u>	<u>(2,35)</u>		Stock (cost Sh.3m)	2,150	-	-
Surplus below/contra:	<u>(1,000)</u>	<u>(750)</u>		Debtors: Good	1,500	3,500	-
Crs partly secured	1,500	1,500		Doubtful	1,000	-	-
Surplus from above/	<u>(1,000)</u>	<u>(850)</u>		Bad	2,500	-	-
Value of security	500	650		Estimated to produce	900	-	-
Preferential Creditors				Investments			650
(Deduct per contra)	<u>250</u>	<u>100</u>	50	Surplus from creditors Fully secured		750	1,200
				Deduct preferential Creditors	(250)	(100)	(50)
				Surplus from Rucha's estate	100	1,050	1,150
				Deficiency as per D A/c	7,000	-	-
Surplus as per surplus A/c	<u>9,000</u>	<u>100</u>	<u>1,300</u>		<u>2,000</u>	<u>1,050</u>	<u>150</u>
	<u>9,000</u>	<u>1,050</u>	<u>1,300</u>		<u>9,000</u>	<u>1,050</u>	<u>1,300</u>

Surplus/Deficiency Accounts

	Ruma Sh '000'	Rucha Sh '000'	Mambo Sh '000'		Ruma Sh '000'	Rucha Sh '000'	Mambo Sh '000'
Excess of Assts Over liabilities	1,000	1,500	150				
Estimate profit on Realization of assets:				Estimated loss on Realization of assets:			
Freehold property	250	350	-	Plant	600	-	-
Other investments	-	450	350	Furniture etc.	300	200	150
Surplus from Rucha's estate	100			Stock	850	-	-
				Debtors	1,600	-	-
				Loss on guarantee on overdraft	-	1,500	-
				Loss on partnership capital	-	500	500
	<u>2,000</u>		<u>150</u>	Surplus as per S.A		<u>100</u>	
	<u>3,350</u>	<u>2,300</u>	<u>650</u>		<u>3,350</u>	<u>2,300</u>	<u>650</u>

QUESTION FOUR

Nyamole Company Limited
Statement of Affairs
As Agt 31st July 20X1

ASSETS NOT SPECIFICALLY PLEDGED

	Estimated Realizable Values Shs.
Cash	115,000
Debtors	500,000
Stock - Finished Goods	500,000
- Raw Materials	300,000
	1,515,000

ASSETS SPECIFICALLY PLEDGED

	Estimated Realizable Values Shs.	Due to Secured Creditors Shs.	Deficiency Ranking as Unsecured Shs.	Surplus Carried to Last column
Land and buildings	1,350,000	1,020,000		330,000
Machinery	650	306,000		344,000
Debtors	400,000	300,000		100,000
Investments	<u>109,000</u>	<u>200,000</u>	<u>(91,000)</u>	<u>774,000</u>
	2,509,000	1,826,999	(91,000)	774,000
Estimated surplus from assets specifically pledged				<u>774,000</u>
				2,189,000

TOTAL ASSETS:		
Specifically Pledged Assets	<u>To Realize</u>	
Unpledged Assets	250,900	
	<u>1,415,000</u>	
	<u>3,924,000</u>	
Less: Liquidation costs		(110,000)
		2,079,000
Less: Preferential Creditors		(305,000)
Less: Partly secured creditors	91,000	1,774,000
Less: Unsecured creditors:		
Creditors	840,000	
Other payables	850,000	
Contingent liability	<u>500,000</u>	<u>(2,281,000)</u>

ESTIMATED DEFICIENCY AS REGARDS CREDITORS 507,000

Deduct:
Issued and paid up share capital 1,000,000

ESTIMATED DEFICIENCY AS REGARDS MEMBERS 1,507,000

Note:

Thus, total interest on mortgages is Shs. (24,200 + 2,000). Apportioned as follows:

- a. D and Buildings $1\text{m}/1.3\text{m} \times 26,000 = \text{shs.}20,000$
- b. Machinery $0.3\text{m}/1.3\text{m} \times 26,000 = \text{shs.}6,000$

Workings: Preferential Creditors:

	Shs.	
Accrued wages	150,000	Assumed the amount is less than Shs.4,000 for Any one employee for 4 months accumulated
PAYE	150,000	
Unrecorded PAYE	<u>5,000</u>	
	<u>305,000</u>	

Creditors

	Shs		Shs
Mort.Int.	2,000	B/d	942,000
Prof.PAYE	150,000		
C/d	<u>840,000</u>	Audit	<u>50,000</u>
	992,000		992,000

Other Payable

	Shs		Shs
Loan	200,000	Bal b/d	1,350,000
Secured creditors	300,000		
Bal c/d	<u>850,000</u>		
	<u>1,350,000</u>		<u>1,350,000</u>

(B)

DEFICIENCY OR SURPLUS ACCOUNT**ITEMS CONTRIBUTING TO DEFICIENCY**

	Shs	Shs
Unrecorded PAYE	5,000	
Loss on machinery	550,000	
Unrecorded mortgage interest	24,000	
Goodwill written-off	200,000	
Travel expenses unrecorded	5,000	
Loss on investment	91,000	
Loss on stock - Finished Goods	100,000	
- Raw Materials	100,000	
Liquidation expenses	110,000	
Audit fee unrecorded	50,000	
Contingent Liability	500,000	
Loss as per Profit & Loss Account	42,000	
Bad debts written off	<u>50,000</u>	
		1,827,000
Items Reducing Deficiency		
Surplus on Land & Buildings	<u>320,000</u>	
		<u>320,000</u>
Deficiency As Shown By Statement		<u>1,507,000</u>

QUESTION FIVE

MR. A IN BANKRUPTCY
Statement to Accompany Payment
Of Dividend to Creditors.

	Shs '000'		Shs '000'
Business Receipts, less payments	1,250	Court Fees and taxed costs	255
Proceeds of sale of assets (gross)	5,300	Auctioneer's fees for sale of assets	300
		Trustee's Remuneration:	
		On realizations (4% x Shs.6.55m)	262.0
		On dividends (8% x Shs.4.92m)	393.6
		Payments to Preferential Creditors	340.0
		Proposed dividend of Shs.49.2 per Shs.100	
		To unsecured creditors	4,920
		Bal c/d	<u>79.4</u>
	<u>6,550</u>		<u>6,550</u>

Assets remaining unsold are estimated to realize shs.2,760,000

(B)

SUMMARY OF TRUSTEE'S CASH BOOK

	Shs ‘000’		Shs ‘000’
Business Receipts, less payments	1,250	Court Fees and taxed costs	255
Proceeds of sale of assets	7,750	Auctioneer's fees for sale of assets	300
		Agents' fees and other outgoings	160
		Trustee's Remuneration:	
		On realizations (4% x Shs.9m) =	360
		On dividends (8% x Shs.7.0231m) =	561.9
		Payments to Preferential creditors	340
		Dividends to Unsecured Creditors:	
		First Dividend of Shs49 per sh.100	4,920
		Second Dividend of	2,103.1
	<u>2,000</u>		<u>79.4</u>
			<u>2,000</u>

LESSON 6

Types of legacy, validity, assent and circumstances of failure thereof.

- a) A specific legacy of ‘my record collection’, which lapses because George predeceased Andrew.
- b) A general legacy of ‘Shs.50,000’ conditional upon the legatee, David, marrying. The condition is not unreasonable, so the legacy must be taken subject to the condition. Thus, as David has clearly expressed his intention not to comply with the condition, the legacy will fail.
- c) A specific legacy of ‘my furniture and personal chattels not otherwise bequeathed’ to ‘my dearest sister-in-law’. As Andrew had three sisters-in-law the legacy will most probably fail for uncertainty of beneficiary unless there is clear evidence available to the court to determine which of the three sisters-in-law was intended; for example, Andrew always referred to one of the three using this term endearment, but never the other two.
- d) A general legacy of ‘a Mini Metro’. As the legacy is general and not specific, it is irrelevant that Andrew has never owned such a car. The executors must assent to the legacy in the absence of a suitable asset forming part of Andrew's estate, must acquire a Mini Metro for the legatee, Peter.
- e) A demonstrative legacy of Shs.200,000, payable out of my account with the Lukenya Building Society. As the legacy is demonstrative and not specific, even though the designated fund is no longer available, the executors must still assent to the legacy and Sandra is entitled to Shs.200,000 payable out of the general assets of the estate.
- f) A specific legacy of ‘the Shs.100,000 in my deposit account with the Trust Bank and as such will be adeemed to the extent that the deposit account does not contain Shs.100,000. thus, Timothy will only be entitled to receive Shs.72,000 in the deposit account at Andrew's death and will have no recourse to the other assets of the estate.
- g) A specific legacy of ‘my 1,000 ordinary shares in Kakuzi Ltd;. Although the asset has changed form (from shs.20 shares to stock units of shs.5 each) since the date of the will, the substance of the asset is unchanged; thus the gift will not adeem the executors should assent to Patrick's receiving the 4,000 units of Kakuzi Ltd. Ordinary stock.
- h) A general legacy of ‘Shs.100,000’ for the refurbishment of the choir stalls at All Saints Cathedral. The purpose of this legacy has already been fulfilled by Andrew during his lifetime; it thus fails to take effect, being adeemed by the lifetime gift.
- i) General legacies of ‘Shs.1.5m. The executors should assent to both legacies, as although Edward predeceases his father, the gift will be saved from lapse by the existence of Edward's own children, alive at Andrew's death. Thus, Francis will receive Shs.1.5m and the Shs.1.5m left to Edward will pass to his estate under the provisions of **THE LAW OF SUCCESSION ACT: PARA 2 SCH2.**

- j) A gift of residue in two parts, a gift of a limited interest to Andrew's two daughters and a gift in remainder to his grandchildren. As both daughters have married prior to Andrew's death, the condition subsequent which terminates their gift of income has already been satisfied. The grandchildren thus hold a vested interest in the residue, which will be held for them on statutory trust until they attain eighteen years of age.

QUESTION TWO

ROBIN DECEASED, DISTRIBUTION STATEMENT

	Shs '000'	Shs '000'	Shs '000'
Specific legacies:			
Wife Annie, furniture and other personal effects			1,345
Daughter Clare, freehold house (Note 1)		6,500	
Less mortgage, including interest thereon for 1 Jan – 31 March 1982 paid by executors (3 months)		<u>(2,060)</u>	4,440
Friend Tony, Mercedes motor car			1,260
Secretary Betty, half of my holding of Ord. Sh.10			
Share in Kenya Breweries being 5,000 shares			600
Cousin Miriam Shs.800,000 5% Kenya Stock			235
Friend Eric, 4,500 Ord. Shs.10 shares in Nation Printers Ltd	740		
plus dividend received (Note 3)	<u>37</u>	777	
Nephew Frank, 4,000 Ord. Shs.10 shares in Kenya Breweries Ltd		480	
Cousin Hazel, debt due from William		<u>120</u>	1,377
			9,257
Demonstrative legacy:			
Niece Tracey, (Note 4)			120
General Legacies:			
Son David		1,000	
Estate of son Jack		1,000	
Friend Gregory Gangla	100		
And later in the will (Note 5)	<u>150</u>	250	
Brother Joseph, 1,000 shared in Brooke Bond Ltd		330	
Niece Tracey, balance of legacy of Shs.200,000		<u>80</u>	2,660
Residual legacy:			
Wife Annie, balance of estate (Note 6)			<u>7,580</u>
			19,617

List of legacies not assented to by the executors:

- Estate of son Stuart, Sh.1 m. This legacy lapses because Stuart who predeceased his father and did not leave issue of his own.
- The legacy to Ben of some of my furniture fails for uncertainty.
- The bequest to Susan of the Renoir painting is adeemed.
- The legacy to Dennis is conditional and Dennis has indicated his refusal to accept the condition.
- Elsie predecease her brother and the legacy of shs.6000,000 lapses.
- The bequest to Miriam of his holding of shares in Cassava Ltd. Is adeemed.
- The legacy to Malcolm, chauffeur lapses. Under the law of commorientes Malcolm (aged 60) is assumed to have died before Robin reached (aged 54).
- Jeremiah, having retired as his gardener does not receive the conditional bequest of shs.150,000.
- Timothy is not bound to accept a legacy and can disclaim it.
- The legacy to St. Peters Church fails as Robin provided such a stained glass window during his lifetime.

Notes:

1. Daughter Clare takes the specific legacy subject to the mortgage and the interest thereon arising after her father's death. It is assumed she will pay the shs.60,000 due from her to the estate before the executors convey the property to her.
2. Cousin Miriam receives the 5% Kenya Loan; a clerical error does not negate a legacy.
3. A specific legacy carries with it any associated income. The dividend on the shares in Nation Printers Limited passes with the shares to Eric.
4. A demonstrative legacy is paid from a designated fund to the extent that the fund exists, any balance being treated as a general legacy.
5. Since the two legacies to Gerry Gangla are of different amounts, it appears that Robin intended his friend to take both legacies.
6. The residue passing to Anne is ascertained as follows:

		Shs '000'	Shs '000
Balance of estate	Bank accounts	8,500	
	Jaguar motor car	720	
	Stamp collection	<u>850</u>	
		10,070	
Less: General legacies		<u>2,660</u>	
			7,410

QUESTION THREE

JACKSON DECEASED (DATE OF DEATH: 1ST APRIL 20x8)

(a)

CASH BOOK

20x8	Total	INCOME Kshs.	CAPITAL Kshs.			INCOME Kshs.	CAPITAL Kshs.
Apr 1	Bal b/f		4,735				
May 1	Est. Income/capital% 2½% SBI <u>300</u>	50	250	May 31	Est. Cap A/c		11,163
Jun 15	Life Ass. Policy A/c		30,000	Aug 10	Debts & Funeral Exp.		650
Jun 30	Building Soci. Dep <u>4,680</u>	90	4,590	Sept. 30	Est. in A/c	67	
Jul 12	9% FS invest %		14,760	20X9			
Aug 1	Est. Inc/Cap. A/c 9% FS Total <u>1,260</u>	840	420	Jan 31	Est. Cap%	-	400
Nov 1	Est. Income A/c <u>300</u>	300					
20X9							
Apr. 1	Est. Inc A/c 9% FS Int <u>450</u>	450		Mar. 31	Bal c/d		
		<u>1,730</u>	<u>54,755</u>			<u>1,663</u>	<u>42,542</u>
20X9						<u>1,730</u>	<u>54,755</u>
Apr. 1	Bal b/f	1,663	42,542				

(b) Two solutions are given to this question.

Solution (i) is based on the assumption that the 2½% Savings Bonds had gone ex-int, and the figure of Kshs.20,020 includes the whole of the impending interest. Solution (ii) is based on the assumption that the 2½% Savings Bond had not gone ex-int and the figure of Kshs.20,020 is the cum-int. value of the stock on 1st April 20x8.

ESTATE CAPITAL ACCOUNT

20x8		solution (i) Kshs.	solution (ii) Kshs.	20x8		solution (i) Kshs.	solution (ii) Kshs.
May 1	2½% SBA	50	-				
May 31	CB (Estate Duty)	11,163	11,163	Apr.1	Bal b/f	84,795	84,795
Jul.12	9% FS In	90	90	May 1	CB	-	250
Oct 2	Distion A/c Wife's Household F/F	3,000	3,000	Aug 4	9% FS Int	420	420
20X9							
Jan 31	CB Adm. Exp.	400	400				
Apr.1	Bal c/d	<u>70,512</u>	<u>70,812</u>				
		<u>82,215</u>	<u>85,645</u>				
					Bal b/d	<u>85,215</u> 70,512	<u>85,465</u>

JACKSON DECEASED
ESTATE STATEMENT OF FINANCIAL POSITION AS AT 1ST APRIL 20X9

	SOLUTION (i)	SOLUTION (ii)		
	Kshs.	Kshs.		
CAPITAL ASSETS	8,250	8,250		
Kshs.10,000 9% Funding Stock 20X6 – 20x8	19,720	20,020		
Kshs.24,000 2½ Saving Bond 20X4 – 20X7	42,542	42,542		
CASH AT BANK	70,512	70,812		
INCOME ASSETS				
CASH AT BANK	<u>1,663</u>	<u>1,663</u>		
	<u>72,175</u>	<u>72,475</u>		
ESTATE CAPITAL ACCOUNT				
ESTATE INCOME ACCOUNT (DUE TO WIDOW)	<u>1,663</u>	70,512	70,812	
		<u>1,663</u>		
		<u>72,175</u>	<u>72,475</u>	

2½ % SAVING BOND A/C

		NOMINAL	INC	CAPITAL		1998		NOMINAL	INC	CAPITAL	
		Kshs.	Kshs.	Kshs.	Kshs.			Kshs.	Kshs.	Kshs.	Kshs.
				(i)	(ii)					(i)	(ii)
Apr.1	Est.Cap A/c	24,000		19,720	20,020	May 1	CB			250	
	Est.Cap A/c.			300		May 1	Est. A./c of Quoted Cum.1			50	
				20,020		20X9 Apr.1	Bal c/d	<u>24,000</u>		<u>19,720</u>	<u>20,020</u>
		<u>24,000</u>		<u>20,020</u>	<u>20,020</u>			<u>24,000</u>		<u>20,020</u>	<u>20,020</u>
20X9											
Apr.1	Bal b/d	24,000		19,720	20,020						

Workings:

ESTATE INCOME ACCOUNT

		Kshs.		Kshs.
			1998	
Sept. 30	CB Int.	67	Nov. 1	50
			Jun. 30	90
			Nov. 1	300
			Aug. 1	840
20X9			20X9	
Mar. 31	Bal c/d	<u>1,663</u>	Feb. 1	450
		<u>1,730</u>		<u>1,730</u>
			20X9	
			Apr. 4	1,663

Debts and Funeral Expenses

	Kshs.		Kshs.
CB	<u>650</u>	Est. Cap A/c	<u>650</u>

Building Society Interest A/C

	Kshs.		Kshs.
Est. Cap. A/c	90	CB	90
Inc. A/c	<u>90</u>	Est. Cap A/c	<u>90</u>
	<u>180</u>		<u>180</u>

Life Policy Account

	Kshs.		Kshs.
		20x8	
Est. Cap A/c	<u>30,000</u>	CB	<u>30,000</u>

BS Deposit Account

	Kshs.		Kshs.
Est. Cap A/c	<u>4,500</u>	CB	<u>4,500</u>

9% FS ACCOUNT

20x8		NOM.	INC	CAPITAL	20x8		NOM	INC	CAPITAL
Apr. 1	Est. Cap. A/c		-	23,100	Jul. 12	CB	18,000		14,760
	Cap. A/c	28,000			Jul. 12	Est. Cap A/c			90
					20X9				
		<u>28,000</u>		<u>23,100</u>	Mar.31	Bal. B/f	<u>10,000</u>		<u>23,100</u>
							<u>28,000</u>		<u>23,100</u>
20X9									
Apr. 1	Bal. B/f	10,000		8,250					

QUESTION FOUR**ESTATE CAPITAL ACCOUNT**

		Kshs.		20x8		Kshs.
Jun.1	CB (Estate Duty)	17,954		May 1	Bal b/d	98,734
Oct. 31	Distribution Account			Aug. 31	Weasol p/c Dividend	40
	Gloria: Per. Chattels	2,000		Aug. 31	CB CTT	4,140
	Pecuniary Legacy	<u>30,000</u>		Sep. 30	R Ltd. F Div.	367
		32,000			Inv in MPLC A/c	
	To Beakie: Inves. In Rat	8,000		Nov. 30	(Profit on disposal: Mouse Ltd)	1,600
	To Harold: Pecuniary Legacy	10,000				
Nov.30	Inv. In Fltd (loss on disposal)	1,6000				
20X9				Jan. 31	CB (MPLC DIV)	140
Apr.30	Estate CB Adm. Expenses	1,500		Feb. 25	CB (WEES P/C DIV)	80
May 1	Bal c/d	<u>34,047</u>				<u>105,101</u>
		<u>105,101</u>		20X9		
				May 1	Bal b/f	34,047

ESTATE INCOME ACCOUNT

20x8		Kshs.	20x8		Kshs.
Oct.31	LEGACY AT 6% P.A FROM 1.5 x 8 TO 31.10 x 8	900	Jun. 30	CB MBS Int	326
Oct. 31	DISTR. A/c Div. TO BEAKIE INT. TO HAROLD	<u>133</u>	Aug.31	CB Weasel P/c DIV	80
			Sep.30	R. Ltd. Final Div.	133
			Oct.31	MBS Int. On Dep.	620
					300
20X9			20X9		
Apr.30	Adm. Expenses	200	Jan.31	Rot CB	600
May 1	Bal. c/d	806	Jan.31	MPLC DIV.	420
			Feb.28	CB (Weasel p/c Div.	<u>160</u>
		<u>2,339</u>			<u>2,339</u>
			20X9		
			May 1	Bal. b/d	806

ESTATE CASH ACCOUNT

		TOTAL	INCOME	CAPITAL			INCOME	CAPITAL
			Kshs.	Kshs.			Kshs.	Kshs.
May1	Est.Cap.A/c			32,000	Jun.1	Est.Cap.A/c		17,954
Jun.30	Income/Tot.	<u>980</u>	326	654	Jun.30	D& F Exp.		4904,300
Aug.31	Inc/Cap.A/c	<u>120</u>	80	40	Oct.31	Invest in UPLC		
Aug.31	Capital A/c			4,140	Oct.31	Dist.A/c to Gloria	900	30,000
Sep.30	Inc/Cap.	<u>500</u>	133	367	Oct.31	Dist.A/c to Beakie	133	
Oct.31	MBS A/c		620	25,000	Oct.31	Dist.A/c to Harold	300	10,000
Nov.30	Inv.in. Frog Ltd.			3,000	Oct.31	Invest in Stoat		14,050
Nov.30	Inv.in MPLC			13,605	Nov			
					Apr.30	Admin.Exp.	200	1,500
20X9								
Jan.31	Est.Inc. A/c	<u>600</u>	600					
Jan.1	Est.Inc/Cap Interim MPLC Div	<u>560</u>	420	140				
Feb.28	Est.Inv/Cap. A/c Final Weasel plc Div	<u>240</u>	<u>160</u>	<u>80</u>	May 1	Bal c/d	<u>806</u>	<u>732</u>
			<u>2,339</u>	<u>79,026</u>			<u>2,339</u>	<u>79,026</u>
			806	732				
May.1	Bal b/d							

DISTRIBUTION ACCOUNT

		Kshs.	Kshs.			Kshs.
SPECIFIC						
Oct.31	To Gloria - Personal Chattel A/c			Oct. 31	Estate Capital A/c	32,000
	Capital cash to Gloria	30,000	2,000	Oct. 31	Estate Income A/c	900
	Income cash	<u>900</u>	30,900	Oct. 31	Estate Capital A/c	8,000
	Invest in Rat Ltd. A/c			Oct. 31	Estate Income A/c	133
				Oct. 31	Estate Capital A/c	10,000
	To Beakie:	8,000			Estate Income A/c (Int)	300
	Income cash	<u>133</u>	8,133			
	To Harold:					
	Capital cash	10,000				
	Income cash	<u>3000</u>	<u>10,300</u>			
			<u>51,333</u>			<u>51,333</u>

NEVILLE DECEASED

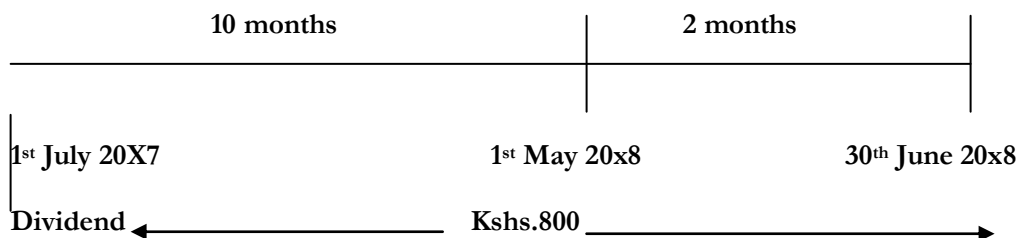
ESTATE BALNCE SHEET AS AT 1ST MAY 20X9

CAPITAL ASSETS

		Kshs.
4,000	Ordinary shares of 25p in Weasels plc	2,960
3,500	Ordinary shares of Kshs.1 in Mouse plc	12,005
5,000	Ordinary shares of Kshs.1 in Stoat plc	14,050
4,000	Ordinary shares of Kshs.1in Op/c	<u>4,300</u>
		33,3315
	Cash at bank	<u>732</u>
		34,047
	INCOME ASSET'S	
	CASH AT BANK	<u>806</u>
		<u>34,853</u>
	ESTATE CAPITAL ACCOUNT	34,047
	ESTATE INCOME ACCOUNT	
	DAVID	403
	DONALD	<u>403</u>
		<u>806</u>
		<u>34,853</u>

Workings:

Final Dividend received for holding in Rat Ltd



For two months (i.e. after Neville's death)

Dividend = $\frac{2}{12} \times 800 =$ Kshs.133 = Income
 Kshs.367 = Capital
 Kshs.500 = Total

Assumption:

For general legacies, interest accrues at 6% per annum for the time period between which they were meant to have been paid and the time they were actually paid.

Date legacies should have been paid = date of death = 1st May 20x8

Date legacies distributed = 31st October 20x8

Time interval = 6 months.

$$\begin{aligned}\therefore \text{Interest to be paid} &\Rightarrow \text{Gloria} = \text{Kshs.}30,000 \times \frac{6}{12} \text{ months} \times 6\% = \text{Kshs.}900 \\ &\Rightarrow \text{Harold} = \text{Kshs.}10,000 \times \frac{6}{12} \text{ months} \times 6\% = \text{Kshs.}300\end{aligned}$$

QUESTION FIVE

Estate Capital Account

		Kshs.	20x8			Kshs.
Mar. 31	Govt. Stock loss on dsp.	1,000	Feb. 1	Bal b/d		91,600
Mar. 30	CB (Estate Duty)	2,250	Feb. 28	Walters Ltd.		700
Apr. 30	Distribution A/c	<u>89,050</u>				<u>92,300</u>
		<u>92,300</u>				<u>92,300</u>

Estate Cash Account

		INCOME	CAPITAL			INCOME	CAPITAL
		Kshs.	Kshs.			Kshs.	Kshs.
Feb. 1	Estate Capital A/c		4,965	Mar.31	Cap. A/c		2,250
Feb.28	Cap. A/c Div.		700	Apr.30	Admin.exp		1,046
Mar.31	Cap. A/c		41,000				
Apr.30	Build Soc A/c		5,081	Apr.30	Dist. A/c	<u>76</u>	<u>48,450</u>
Apr.30	CB	<u>76</u>				<u>76</u>	<u>51,746</u>
		<u>76</u>	<u>51,746</u>				

Distribution Account

		Kshs.			Kshs.
SPECIFIC LEGACIES		24,000	Estate Capital A./c		89,050
To wife Jane: Freehold house		3,600			
To wife Jane: Personal Chattels		10,000	Estate Income A/c		76
7,000 ordinary shares if Walters Ltd.		<u>3,000</u>			
3,000 Ordinary shares If Chattels		40,600			

GENERAL LEGACIES

	GROSS	ABAT	NET		
To wife Jane cash	15,000	5,310	9,690		
Daughter CB	21,600	7,646	13,954		
To son George	12,000	4,248	7,752		
Harold Estate	12,000	4,248	7,752		
Fredrick	12,000	4,248	7,752		
To friend Charles	<u>2,400</u>	<u>850</u>	<u>1,550</u>		
	75,000	(26,550)		48,450	
				<u>76</u>	
Income arising to wife				<u>89,126</u>	<u>89,126</u>

LESSON 7

QUESTION ONE

Onyango Trust
Estate Capital Account

		Kshs.	20X4			Shs
(1)						
20X4						
Mar.31	Distrib. A/c	285,000	Jan.1	Bal b/f		520,000
			Mar.31	K Ltd Inv. A/c		30,000
Mar.31	Bal c/d	<u>285,000</u>	Mar.31	K Ltd Inv. A/c		<u>20,000</u>
		<u>570,000</u>				<u>570,000</u>
			20X4			
			Apr. 1	Bal b/d		285,000

(2)

Accumulation Accounts

20X4		Abel Shs	Beatrice Shs	20X4		Abel Shs	Beatrice Shs
Jan. 31	CB	3,000	2,000	Jan.1	Bal b/f	15,000	10,000
Mar. 31	Dist. A/c	18,800		Jan.1	CB(Inc on Acc.Inv)	5,000	5,000
Mar.31	Bal c/d		14,200	Jan.1	CB(Inc on Acc.Inv)	300	200
				Mar.31	Inv. In K Ltd A/c	900	600
				Mar.31	Inv. In K Ltd A/c	<u>600</u>	<u>400</u>
		<u>21,800</u>	<u>16,200</u>			<u>21,800</u>	<u>16,200</u>
				20X4			
				Apr.1	Bal b/d		14,200

Workings:**DISTRIBUTION STATEMENT**

	Book Value Shs	Market Value Shs	Nominal Value Shs	Abel Shs	Nominal Value Shs	Trust (for Beatrice) Shs
Capital Investment						
20,000 Shs 10 Ord. Shares in K Ltd.	220,000	250,000	110,000	125,000	110,000	125,000
30,000 Shs 10 Ord. Shares in L Ltd.	280,000	300,000	150,000	150,000	150,000	150,000
Cash	<u>20,000</u>	<u>20,000</u>	—	<u>10,000</u>	—	<u>10,000</u>
	<u>520,000</u>	<u>570,000</u>		<u>285,000</u>		<u>285,000</u>

Income (Accum.) Investments

1,000 Shs 10 Ord. Shares in K Ltd	11,000	12,500	6,000	7,500	4,000	5,000
1,000 Shs 10 Ord. Shares in L Ltd	9,000	10,000	6,000	6,000	4,000	5,000
Cash	<u>10,500</u>	<u>10,500</u>		<u>5,300</u>		<u>5,200</u>
	<u>30,500</u>	<u>33,000</u>		<u>18,800</u>		<u>14,200</u>

(3)

Distribution A/c - Abel

20X4		Shs 20X4	Shs
Mar.31	Capital Assets:	Mar.31	Est.Cap. A/c
	10,000 Shs 10 Ord. Shares in K Ltd	125,000	Mar.31
	15,000 Shs 10 Ord. Shares in L Ltd	150,000	Accum. A/c
	Cash Book - Cash	<u>10,000</u>	18,800
		<u>285,000</u>	
Mar.31	Income Assets:		
	600 Shs 10 Ord. Shares in K Ltd	7,500	
	600 Shs 10 Ord. Shares in L Ltd	6,000	
		5,300	
	Cash	<u>18,800</u>	
		<u>303,800</u>	<u>303,800</u>

QUESTION TWO

Abincha Trust: Date of Death 31st March 20X5
Cash Account

(a)

	INCOME		CAPITAL		20x8		INCOME		CAPITAL	
	Shs	Shs	Shs	Shs			Shs	Shs	Shs	Shs
Bal b/f	7,640		1,000	1,000	May. 31	FI/WR Cash -	120,000			
Accum. A/c	500				Jun. 10	Inv. in z Ltd				
Accum. A/c	7,500					(3,840 Sh.10				
Land A/c		120,000				Ord.shares)				96,000
SRCB - Contra			60,000	60,000	Jun. 10	Inv in 5% Govt.				
Inv.in S Ltd				35,000		St. 19Y4 (Shs			61,000	
Accum. A/cs	800				Jun. 30	Accum. H28A/cs:				
						Maintenance	3,250			
					Jul. 31	Bruce Accum				
					Jul. 31	A/c	10,393			
					Jul. 31	Bal c/d	<u>2,797</u>			
	<u>16,440</u>	<u>120,000</u>	<u>61,000</u>	<u>96,000</u>			<u>16,440</u>	<u>120,000</u>	<u>61,000</u>	<u>96,000</u>
Aug. 1	Bal c/d	2,797								

(b)

Capital Accounts

20x8		SRF	FIF	WRF	20x8		SRF	FIF	WRF
		Shs	Shs	Shs			Shs	Shs	Shs
May. 31	FIF/WRF - Contra	120,000			Apr. 1	Bal b/f	60,000	250,000	50,000
Jul. 31	Distrib. A/c				May. 31	Land A/c			
	Bruce		218,500	26,125		(Profit on Disp.)	60,000		
Jul. 31	Bal c/d		129,775	359,475	May. 31	SRF - Contra		60,000	60,000
					May. 31	Inv. in S Ltd			
						(Profit)			5,000
					Jun. 30	Inv. in 4% Nat.st		1,000	
					Jul. 31	Subdry Inv. A/cs			
						Revaluation			
						Surplus		<u>37,275</u>	<u>70,600</u>
		<u>120,000</u>	<u>348,275</u>	<u>385,600</u>			<u>120,000</u>	<u>348,275</u>	<u>385,600</u>
					Aug. 1	Bal b/d		129,775	359,475

(c)

Accumulations Accounts

20x8		BRUCE	CHRIS	DAN	20x8		BRUCE	CHRIS	DAN
		Shs	Shs	Shs			Shs	Shs	Shs
June. 30	CB: Maintenance	1,500	900	850	Apr.1	Bal b/f	8,000	12,000	12,000
Jul.31	CB	10,393			Apr.30	CB (5% Div. S Ltd)	167	167	167
Jul.31	Bal c/d		15,474	15,523	Apr.30	CB (6% G. St. Int.)	2,500	2,500	2,500
					Jun.30	CB (4% Nat.St. Int.)	266	267	267
					Jul.31	Inv.in 6% Nat. St.A/c			
		<u>11,893</u>	<u>16,374</u>	<u>16,373</u>	Aug.1	Bal c/d	15,474	15,523	

(d) Trust Statement of financial position as at 31st July 20x8

Fixed Interest Assets:		Shs	Shs
Shs 40,000 8% Govt. Stock 19Y8		39,100	
Shs 20,000 6% Govt Stock 19Y5		19,000	
Shs 76,000 5% Govt Stock 19Y4		<u>71,675</u>	
			129,775
Wider Range Assets:			
10,000 Shs 10 Ord. Shares in G Ltd		280,000	
2,890 Shs 10 Ord. Shares in Z Ltd		<u>79,475</u>	
			359,475
Accumulation Assets:			
Shs 30,000 6% National Stock 19Y5		28,200	
Cash at Bank		<u>2,797</u>	
			30,997
Assets Due to Bruce:			
Shs 230,000 6% Govt. Stock 19Y5		218,500	
950 Shs 10 Ord. Shares in Z Ltd		<u>26,125</u>	<u>244,625</u>
			764,872
Fixed Interest Fund		129,775	
Wider Range Fund		<u>359,475</u>	489,250
Accumulations Accounts:	Chris	15,474	
	Dan	<u>15,523</u>	30,997
Due to Bruce			<u>244,625</u>
			<u>764,872</u>

Workings: Distribution Statement

Assets:	Book	MV Due To Bruce		To Remain in Trust		
	Value	31.7.X8	Nominal	MV	Nominal	MV
	Shs	Shs	Shs	Shs	Shs	Shs
Shs 40,000 8% Govt. St 19Y8	40,000	39,100	–	–	40,000	39,100
Shs 250,000 6% Govt St 19Y5	210,000	237,500	230,000	218,500	20,000	19,000
Shs 76,250 5% Govt St 19Y4	<u>61,000</u>	<u>71,675</u>	–	–	76,250	<u>71,675</u>
	<u>311,000</u>	<u>348,275</u>		<u>218,500</u>		<u>129,775</u>
Wider Range						
10,000 Shs 10 Ord. Shares in G Ltd	219,000	280,000	–	–	100,000	280,000
3,840 Shs 10 Ord. Shares in z Ltd	<u>96,000</u>	<u>105,600</u>	9,500	<u>26,125</u>	28,900	<u>79,475</u>
	<u>315,000</u>	<u>385,000</u>		<u>26,125</u>		<u>359,475</u>
TOTAL CAPITAL ASSETS	<u>626,000</u>	<u>733,875</u>		<u>244,625</u>		<u>489,250</u>
Accumulation Assets:						
Shs 30,000 6% National St. 19Y5	24,360	28,200	–	–	30,000	28,200
Cash at Bank	<u>13,190</u>	<u>13,190</u>		<u>10,393</u>		<u>2,797</u>
	<u>37,550</u>	<u>41,390</u>		<u>10,393</u>		<u>30,997</u>

QUESTION THREE

KAMAU DECEASED (DATE OF DEATH 30.6.X4)
Accumulations Accounts

(a)

		Maina shs'000	Njoroge shs'000	Karanja shs'000			Maina shs'000	Njoroge shs'000	Karanja shs'000
20X4					20X5				
Dec.31	CB (Maintenance)	5	5	10	Jun.30	Cash			
20X5						Book (Inc)	100	100	100
Jun.30	CB (Maintenance)	15	25	30					
Jun.30	Bal c/d	<u>80</u>	<u>70</u>	<u>60</u>					
		<u>100</u>	<u>100</u>	<u>100</u>			<u>100</u>	<u>100</u>	<u>100</u>
20X5					20X5				
Dec.31	CB (Maintenance)	20	40	50	Jul.1	Bal b/d	80	70	60
20X6					20X6				
Mar.31	Inv A/cs				Mar.31	Cash Book			
	(Loss on Rival)	2.5	2.2	1.9		(Cap. Inc	90	90	90
Mar.31	Distribution A/c			105.3	Mar.31	CB			
	Balance c/f	<u>157.1</u>	<u>126.2</u>			Accum. Inc.)	<u>9.6</u>	<u>8.4</u>	<u>7.2</u>
		<u>179.6</u>	<u>168.4</u>	<u>157.2</u>			<u>179.6</u>	<u>168.4</u>	<u>157.2</u>
					20X6				
					Apr.1	Bal b/d	157.1	126.2	

(b) **Statement of distribution**

i.	General Fund	Book	MV	Due to Karanja		To Remain in Trust	
		Value	31.3X6	Nominal	MV	Nominal	MV
		Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
	Assets						
	Sh. 1m M Ltd 9% Deb.St.	830	870	399	347	471	523
	Sh. 1.5m N Ltd 10% Loan St.	1,480	1,425	500	475	1,000	950
	Sh. 1.8 O Ltd 6% St.	1,100	1,062	600	354	1,200	708
	Sh. 0.3m P Ltd 6% St.	<u>190</u>	<u>171</u>	—	—	300	<u>171</u>
		<u>3,600</u>	<u>3,528</u>		<u>1,176</u>		<u>2,352</u>
ii.	Accumulations Fund						
	Sh 70,000 M Ltd 9% Deb.St.	61	60.9	70	60.9	—	—
	Sh 150,000 N Ltd 10% Loan St.	<u>149</u>	<u>142.5</u>	—	—	149	142.5
		210	203.4				
	Cash	<u>185.2</u>	<u>185.2</u>		<u>44.4</u>		<u>140.8</u>
		395.2	388.6		105.3		283.3

(C) Trust Statement of financial position as at 31st March 20X6

	Shs	Shs
Capital Assets		
Shs 0.477m 9% Deb. St in M Ltd	523.00	
Shs 1 m 10% Loan St. in N Ltd	950.00	
Shs 1.2m 6% St in O Ltd	708.00	
Shs 0.3m 6% St in P Ltd	<u>171.00</u>	2,352.00
Accumulation Assets		
Shs 0.149m 10% Loan St. in N Ltd	142.50	
Cash at Bank	<u>140.80</u>	<u>283.30</u>
		<u>2,635.30</u>
Trust Capital Account		2,352.00
Accumulations Accounts:		
Maina	157.10	
Njoroge	<u>126.20</u>	
		<u>283.30</u>
		<u>2,635.30</u>

LESSON 8

(a) See notes

(b) (i) **Wafanyakazi retirement benefit Scheme**
Statement of changes in net assets for the year ended 31 October 2002

	Sh.	Sh.
<u>Contributions received</u>		
From employer: Normal	18,240	36,480
From members: Normal	<u>4,560</u>	22,800
Additional voluntary		
<u>Transfer in</u>		
From other sources (individual transfers in)		3,150
Investment income		<u>47,400</u>
		109,830
<u>Benefits payable</u>		
Pensions	7,640	
Commutations of pensions and lumpsum benefits	<u>4,820</u>	

Payments on accounts of leavers: individual transfer out	<u>1,860</u>	<u>(14,320)</u>
		95,510
Changes in market value of investments		<u>(22,640)</u>
		72,870
Payments: Administration expenses		<u>(2,840)</u>
		<u>70,030</u>

Wafanyakazi retirement benefit Scheme
Statement of net assets as at 31 October 2002

	Sh.	Sh.
Investment assets		
Fixed interest securities		
Kenya Government securities		263,605
Equity investments		
Quoted	87,835	
Unquoted	<u>19,990</u>	107,825
Cash and demand deposits		<u>23,460</u>
		394,890
Fixed Assets:		
Freehold property		<u>132,320</u>
		527,210
Current Assets		
Contributions due within 30 days	4,940	
Current liabilities		
Unpaid benefits	(320)	
Accrued expenses	<u>(240)</u>	
	<u>(560)</u>	4,380
		<u>531,590</u>
Accumulated fund as at 01.11.01		461,560
Net change for the year		<u>70,030</u>
		<u>531,590</u>

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATION BOARD
FINANCIAL ACCOUNTING III

December 2005

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

Soma Ltd., publishing and printing company, extracted the following trial balance as at 31 October 2005:

	Sh. '000'	Sh. '000'
Property, plant and equipment: Cost	907,722	
Accumulated depreciation		108,000
Intangible assets	120,000	
Inventory	120,700	
Accounts receivable	168,120	
Provision for doubtful debts		620
Cash in hand	100	
Accounts payable		127,450
Bank overdraft		50,754
12½% debentures		200,000
Bank loan		270,000
Corporation tax		47,500
Share capital		60,000
Retained profits		119,046
Sales		1,574,500
Cost of sales	670,396	
Salaries and wages	238,720	
Distribution cost	86,560	
Administrative expenses	165,592	
Interest charges	79,960	
	<u>2,555,870</u>	<u>2,557,870</u>

Additional Information

1. Details of property, plant and equipment were as follows:

Values as at 1 November 2004	Cost	Accumulated depreciation
	Sh. '000'	Sh. '000'
Freehold property (land Sh.350 million)	500,000	-
Plant and machinery	200,000	90,000
Office equipment	<u>107,722</u>	<u>18,000</u>
	<u>807,722</u>	<u>108,000</u>

The company had not been providing for depreciation on freehold property which comprised land and buildings. These were acquired on 1 November 1995, on which date the buildings were

estimated to have a useful life of 50 years. The directors have now agreed to provide depreciation from the date of acquisition.

Depreciation on the other items of property, plant and equipment is to be provided for as follows:

Plant and machinery	- 15% on straight line basis
Office equipment	- 10% on reducing balance basis

A plant which cost Sh.100 million was acquired during the year.

- The cost of inventory as at 31 October 2005 included items valued at Sh.9.6 million that were considered to be obsolete. The remaining inventory had a value of Sh.111.1 million.
- Provision for doubtful debts at 5% of the accounts receivable is to be made.
- The bank loan is repayable in ten equal annual installments of Sh.30 million.
- The corporation tax amounting to Sh.47.5 million represents the estimated tax charge for the previous year. This liability was agreed with the tax authority at Sh.45 million. Current year tax is estimated to be Sh.85 million.
- The details of salaries and wages were:

SH. '000'

Factory wages	125,510
Warehouse wages	32,716
Office salaries	79,780
Directors' remuneration	<u>714</u>
	<u>238,720</u>

The interest charges comprise:

SH. '000'

Bank overdraft interest	25,460
Bank loan interest	42,000
12½% debenture interest	<u>12,500</u>
	<u>79,960</u>

Intangible assets are to be amortised over 5 years. Amortisation and depreciation charges are to be treated as part of the cost of sales.

The directors propose to pay dividend amounting to Sh.21 million in respect of the year ended 31 October 2005.

Required:

- Income statement for the year ended 31 October 2005. **(8 marks)**
- Statement of changes in equity for the year ended 31 October 2005. (show the column for retained profits only). **(2 marks)**
- Statement of financial position as at 31 October 2005. Include relevant notes, using only the information provided, to ensure that the financial statements meet the requirements of

International Financial Reporting Standards (IFRSs).
(12 marks)

(Total:22 marks)

QUESTION TWO

The consolidated financial statements for Hipa group for the year ended 30 September 2005 together with the comparative statement of financial position for the year 30 September 2004 are shown below:

Consolidated income statement for the year ended 30 September 2005:

	Sh. 'million'	Sh. 'million'
Sales		3,820
Cost of sales		<u>(2,620)</u>
Gross profit		1,200
Operating expenses	300	-
Finance costs	<u>30</u>	<u>(330)</u>
Profit before tax		870
Share of profit after tax of associate company		<u>20</u>
		890
Income tax expense		<u>(270)</u>
Profit for the period		<u>620</u>
Attributable to holding company		580
Attributable to minority interest		<u>40</u>
		<u>620</u>

Consolidated statement of financial position as at 30 September:

	2005		2004	
	Sh. 'million'	Sh. 'million'	Sh. 'million'	Sh. 'million'
Non-Current assets:				
Property, plant and equipment		1,890		1,830
Intangible assets		650		300
Investment in associate company		<u>95</u>		<u>80</u>
		2,635		2,210
Current Assets:				
Inventory	1,420		940	
Accounts receivable	990		680	
Cash	<u>70</u>	<u>2,480</u>	<u>-</u>	<u>1,620</u>
		<u>5,115</u>		<u>3,830</u>
Equity and liabilities:				
Capital and reserves:				
Ordinary shares (Sh.10 each)		750		500
Reserves:				
Share premium	350		100	
Revaluation reserves	140		-	
Retained profits	<u>1,570</u>	<u>2,060</u>	<u>1,380</u>	<u>1,480</u>
Shareholders funds		2,810		1,980
Minority interest		135		100

Non-current liabilities:

10% debentures	300		100	
Bank loan	260		300	
Deferred tax	<u>310</u>	870	<u>140</u>	540
Accounts payable	875		730	
Bank overdraft	-		115	
Accrued loan interest	15		5	
Proposed dividend	280		200	
Current tax	<u>130</u>	<u>1,300</u>	<u>160</u>	<u>1,210</u>
		<u>5,115</u>		<u>3,830</u>

Additional Information

- The cost of sales includes depreciation of property, plant and equipment amounting to Sh.320 million and a loss on sale of plant of Sh.50 million.
- Intangible assets comprise:

	2005	2004
	Sh. 'million'	Sh. 'million'
Goodwill	180	200
Others	<u>470</u>	<u>100</u>
	<u>650</u>	<u>300</u>

Included in the amount above were tangible assets acquired during the year ended 30 September 2005 for sh.500 million.

- During the year ended 30 September 2005, the holding company acquired a new plant which cost Sh.250 million. The company also revalued its buildings by Sh.200 million.
- On 1 October 2004, the holding company made a bonus issue of 1 share for every 10 shares held. The issue was financed through the revaluation reserve.
- The detailed analysis of the retained profits was as follows:

	2005	2004
	Sh. 'million'	Sh. 'million'
Balance brought forward	1,380	1,200
Profit for the year	<u>580</u>	<u>480</u>
	1,960	1,680
Transfer from revaluation reserves	10	-
Dividend paid and proposed	<u>(400)</u>	<u>(300)</u>
Balance carried forward	<u>1,570</u>	<u>1,380</u>

Required:

Group cash flow statement for the year ended 30 September 2005, using the indirect method in conformity with International Accounting Standard (IAS)7. **(20 marks)**

QUESTION THREE

Beta East Africa Ltd. Manufactures tubeless tyres at its head office plant located in Nairobi. It operates an overseas outlet at Kampala which maintains its own books of account.

The tyres are transferred to the branch at head office cost plus 25% mark-up. All sales are at a uniform margin of 50%.

The trial balances extracted from the books of both the head office and the Kampala branch as at 30 June 2005 were as follows:

	Head office		Kampala branch	
	Ksh. '000'	Ksh. '000'	Ush. '000'	Ush. '000'
Cash at bank	6,000		130,000	
Accounts receivable	45,000		260,000	
Inventory – 30 June 2005	40,000		80,000	
Plant and equipment – net book value	150,000			
Accounts payable		44,000		65,000
Share capital		192,000		
Motor vehicles – net book value	50,000			
Branch and head office current accounts	15,000			95,000
Sales		390,000		1,600,000
Cost of goods sold	280,000		930,000	
Operating expenses	70,000		360,000	
Goods sent to branch		30,000		
	<u>656,000</u>	<u>656,000</u>	<u>1,760,000</u>	<u>1,760,000</u>

Additional Information

1. Goods sent to Kampala branch by the head office which had cost the head office Ksh.80,000 were received by the branch on 15 July 2005. Included in the closing stock of Kampala branch were goods received from head office valued at Ush.23,600,000. The balance of the inventory at the Kampala branch were purchased locally in Uganda when the exchange rate was Ush.12 to Ksh.1.
2. A customer of the head office whose operations are situated in Kampala, made a settlement of Ush.420,000,000 to Kampala branch on 15 June 2005. This transaction was properly recorded by the Kampala branch but the head office had not been notified by the time the trial balance was extracted on 30 June 2005.
3. Depreciation is to be provided on plant and motor vehicles using the reducing balance method at 10% and 20% respectively per annum.
4. The head office expenses include Ksh.3,000,000 that related to Kampala branch. The head office allocates 1/3 of the depreciation expenses on plant and equipment to the branch.

5. The rates of exchange prevailing on various dated were:

Date	Rate
1 July 2004	9 Ush./Ksh.
15 June 2005	12 Ush./Ksh.
30 June 2005	13 Ush./Ksh.

Average rate for the year was 10 Ush./1Ksh. Goods transferred to Kampala branch were translated at the rate of 10 Ush./1Ksh.

Required:

- Branch trial balance in Kenya shillings after the necessary adjustments. (5 marks)
- Income statement (in Kenya shillings) for the head office, branch and the combined business, in columnar format, for the year ended 30 June 2005.** (10 marks)
- Combined statement of financial position (in Kenya Shillings) as at 30 June 2005. (5 marks)

(Total:20 marks)

QUESTION FOUR

Kuni and Moto were partners in a business of logging and saw milling sharing profits and losses equally. The partnership statement of financial position as at 31 December 2004 was as follows:

	Sh. '000'	Sh. '000'
Non-current assets:		
Land and building (at cost)		93,250
Furniture (at cost less accumulated depreciation)		<u>2,500</u>
		95,750
Current assets		
Cash in hand		250
Accounts receivable		
Saw milling	32,000	
Logging	<u>54,000</u>	86,000
Inventory		
Saw milling	115,000	
Logging	<u>56,250</u>	<u>171,250</u>
		<u>257,500</u>
Total assets		<u>353,250</u>
Capital and liabilities		
Capital accounts: Kuni		131,500
Moto		<u>81,000</u>
		<u>212,500</u>
Non-current liability:		
Loan		<u>6,000</u>

Current liabilities		
Bank overdraft		44,750
Creditors:		
Saw milling	77,000	
Logging	<u>13,000</u>	<u>90,000</u>
		<u>134,750</u>
Total capital and liabilities		<u>353,250</u>

Additional Information

- The partners agreed that effective from 1 January 2005, the business would be taken over by two separate limited companies, Kuni Ltd. And Moto Ltd. Took over the saw milling business and Moto Ltd. Took over the logging business.
- The providers of the loan agreed to accept 10% debentures in the new companies; Sh.3,600,000 being applicable to Kuni Ltd. And Sh.2,400,000 to Moto Ltd.
- Kuni Ltd. took over the land and buildings, furniture, cash and bank overdraft. The assets and the liabilities were transferred at book values and the partners were paid Sh.25,000,000 being goodwill for the saw milling business and Sh.20,000,000 for the logging business
- On 1 January 2005, the purchase consideration was satisfied by the allotment of fully paid equity shares of Sh.10 each in the respective companies as shown below:
 - Kuni – 11,875,000 shares in Kuni Ltd. and the balance in Moto Ltd.
 - Moto – 7,960,000 shares in Moto Ltd. and the balance in Kuni Ltd.
- Kuni Ltd. Also raised a 12% debenture of Sh.50,000,000 on 1 January 2005 and paid-off the bank overdraft. The expenses incurred in raising the debenture amounted to Sh.1,750,000.
- Kuni Ltd. And Moto Ltd. Also issued 500,000 and 750,000 full paid ordinary shares of Sh.10 each respectively to B Ltd. And C Ltd. on 1 January 2005.
- The formation expenses were paid by the respective companies as follows: Kuni Ltd. Sh.3,250,000 and Moto Ltd. Sh.2,000,000.

Required:

- Prepare business purchase accounts, partners' capital accounts, vendor account and bank accounts to record the above transactions. (12 marks)
 - Opening statement of financial position of Kuni Ltd. And Moto Ltd. (8 marks)
- (Total:20 marks)

QUESTION FIVE

- With reference in International accounting Standard (IAS) 19 on employees benefits:

- i) Differentiate between the terms “defined contribution plans” and “defined benefit plans”.
(3 marks)
- ii) Outline the two circumstances under which an enterprise should recognize termination benefits as a liability and an expense.
(3 marks)
- b) Treasure Motors Ltd. Is a dealer in new and used motor vehicles. In June 1993, the company registered a retirement benefits scheme for its 10 employees under the name “Treasure Motors Retirement Benefits Scheme”.

The trustees of the scheme extracted the following trial balance as at 30 June 2005.

	Sh.	Sh.
Pensions and commutations	209,000	
Withdrawals from scheme	15,000	
Management expenses	7,000	
Members' contribution		250,200
Interest on investment		640,000
Provision for exchange losses		160,000
Investment in quoted shares	3,000,000	
Investment in unquoted shares	2,500,000	
Government securities	590,000	
Premises	800,000	
Offshore investments in shares	1,200,000	
Employer's contributions		630,000.600
Accumulated fund balance as at 1 July 2004		7,640,000
Fixed deposits	260,000	
Receivable from employer	635,600	
Payable to members		8,000
Income receivable	<u>80,000</u>	
	<u>9,328,800</u>	<u>9,328,800</u>

Required:

- i) Statement of changes in net assets for the year ended 30 June 2005.
(6 marks)
- ii) Statement of net assets as at 30 June 2005.
(6 marks)
(Total: 18 marks)

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATION BOARD**FINANCIAL ACCOUNTING III****June 2005****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

Jembe and Panga were sole traders manufacturing farm implements. On 31 March 2004, they amalgamated and traded as partners sharing profits and losses in the ratio of 3:2. One year later on 31 March 2005, they converted the partnership into a limited liability company called Shamba Ltd.

No. adjustments have been made to record the amalgamation and conversion but the statement of financial positions for the sole traders as at 31 March 2004 and the partnership as at 31 March 2005 were as follows:

	Sole Traders statement of financial position as at 31 March 2004		Partnership statement of financial position as at 31 March 2005
	Jembe Sh. '000'	Panga Sh. '000'	Sh. '000'
Assets			
Freehold property	1,500	1,000	4,000
Plant and equipment	6,800	5,600	13,000
Fixtures and fittings	1,600	1,550	3,000
Inventory	1,800	350	3,350
Accounts receivable	1,900	1,000	6,420
Balance at bank	<u>300</u>	<u>150</u>	<u>125</u>
	13,900	9,560	29,895
Liabilities			
Accounts payable	(6,800)	(4,000)	(9,920)
Bank overdraft	<u>-</u>	<u>-</u>	<u>(5,625)</u>

7,10005,65014,350

Additional Information:

1. On 1 April 2004, 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:

	Jembe Sh. '000'	Panga Sh. '000'
Freehold property	2,000	1,500
Plant and equipment	6,500	5,500
Fixtures and fittings	1,500	1,500

2. During the year ended 31 March 2005, Jembe made drawings of Sh2,390,000 while Panga drew sh.610,000.
3. The partnership was converted into a limited company on the following terms:
- The freehold property and accounts receivable were revalued to Sh.6,00,000 and Sh.5,670,000 respectively.
 - Jembe and Panga 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 31 March 2005 (that is after accounting for the profit, drawings and revaluation in note (i) above).
 - Shamba Ltd. Authorized share capital was made up of 150,000 ordinary shares of Sh.50 each. Out of which 130,000 shares were to be issued to the partners in their profit sharing ratio.
 - Any balances in the partners' capital accounts were to be settled in cash.

Required:

- A computation showing the value of debentures and ordinary shares to be issued to the partners. (12 marks)
- Partners capital accounts as at 31 March 2005. (3 marks)
- Statement of financial position of Shamba Ltd. As at 31 March 2005 after completing the above transactions.

(5 marks)

(Total: 20 marks)**QUESTION TWO**

Lusiola Ltd. Acquired 90% of the ordinary shares of Kacheliba Ltd. On 1 April 2003 for 30 million when Kacheliba Ltd's retained earnings were Sh.15 million.

The statement of financial position of the two companies as at 31 March 2005 were as follows:

	Lusiola Ltd. Sh. '000'	Kacheliba Ltd. Sh. '000'
Non-current assets:		
Property, plant and equipment	26,400	16,200
Investment in Kacheliba Ltd.	30,000	
Other investments	<u>1,000</u>	<u>6,000</u>
	57,400	22,200
Current assets		
Inventory	9,500	4,000
Accounts receivable	7,200	1,500
Bank	<u>300</u>	
	<u>17,000</u>	<u>5,500</u>
Total assets	<u>74,400</u>	<u>27,700</u>
Equity and liabilities:		
Ordinary share capital (Sh.10 each)	10,000	5,000
Retained earnings	<u>48,600</u>	<u>6,300</u>
	58,600	11,300
Non-current liabilities		
12% debentures	4,000	6,000
Current liabilities		
Accounts payable	6,700	5,200
Taxation	4,100	700
Dividends	1,000	-
Overdraft	<u>-</u>	<u>4,500</u>
	<u>11,800</u>	<u>10,400</u>
Total equity and liabilities	<u>74,400</u>	<u>27,700</u>

Additional Information

- The movement in Kacheliba Ltd.'s earnings since acquisition was as follows:

	Sh. '000'
Balance as at 1 April 2003	15,000
Loss for the year ended 31 March 2004	(3,000)
Loss for the year ended 31 March 2005	(1,700)
Dividend paid in the year ended 31 March 2005	<u>(1,400)</u>
Balance as at 31 March 2005	<u>(6,300)</u>

- Lusiola Ltd. Accounted for its share of Kacheliba Ltd.'s dividend as a credit to income. The group policy on dividend is to credit group income with dividend paid out of post acquisition profit only.
- On the date of acquisition, the fair values of Kacheliba Ltd.'s assets were approximately equal to their book values except for
 - Plant which had a net replacement value of sh.6 million in excess of its book value and an estimated remaining useful life for 5 years.
 - Investments with market values of sh.8 million.
- There were no acquisitions or disposals of non-current assets since 1 April 2003.

5. The group policy in relation to goodwill arising from acquisition was to capitalise it and amortise it over 6 years. However, in line with International Financial Reporting Standard (IFRS 3) goodwill was tested for impairment from 1 April 2004 to 31 March 2005 and found to be impaired by 16.67%. amortisation for the year ended 1 March 2004 had been provided.
6. On 27 March 2005, Lusiola Ltd. Sold goods to Kacheliba Ltd. For Sh.6,000. These goods had not been received by 31 March 2005 and were excluded from Kacheliba Ltd. Inventory. Lusiola Ltd. Charges goods at a standard mark-up on cost of 20%. Prior to this transaction, the agreed purchase ledger accounts balance of Kacheliba Ltd. With Lusiola Ltd. Was Sh.1,400,000.

Required

Group statement of financial position as at 31 March 2005

(20 marks)

QUESTION THREE

Jamila traders has a head office in Nanyuki and an automation branch in Thika. The trial balances of head office and the branch as at 30 September 2004 were as follows:

	Head office		Thika branch	
	Sh.	Sh.	Sh.	Sh.
Buildings (at cost)	3,500,000			
Goods sent to branch		6,482,205		
Goods received from head office			6,387,330	
Accounts receivable	764,700		535,800	
Remittance from branch		7,548,750		
Remittances to head office			7,620,000	
Cash at bank	397,800		289,250	
Stock (at cost)	2,595,000			
Stock (at mark up)			1,552,500	
Sales		13,000,000		9,202,200
Capital (1 October 2003)		6,040,925		
Bank overdraft				250,000
Furniture and fittings	779,500		230,500	
Purchases	13,626,600			
Rent and rates	395,400		197,250	
Salaries and wages	851,700		487,500	
Current accounts	8,931,555			8,836,680
General expenses	1,887,750		1,258,950	
Accounts payable		1,239,000		270,200
Drawings	783,375			

Provision for unrealised profits	<u>34,513,380</u>	<u>202,500</u> <u>34,513,380</u>	<u>18,559,080</u>	<u>18,559,080</u>
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Additional Information

1. Depreciation on furniture and fittings is to be provided at the rate of 10% per annum using the reducing balance method.
2. A bonus of 10% is payable to the staff at the head office and the branch. The bonus is based on net profits after charging these bonuses.
3. Goods sent to the branch in August 2004 and which had an invoice value of Sh.94,875 were stolen in transit. The insurance company agreed to meet the claim to the extent of only 85% of the cost of the goods.
4. Goods were invoiced to the branch at 15% above cost all sales were at a mark up of 331/3% above the cost to head office.
5. No shortages of stock were reported at the head office or the branch.

Required:

Prepare in columnar form for the head office, Thika branch and the combined business. The income statements for the year ended 30 September 2004. (12 marks)

QUESTION FOUR

Hamed and Hassan were in partnership trading under the name 'Medsan Traders' and sharing profits and losses in the ratio of 1:3 respectively. On 31 December 2004, a winding up petition was lodged against the firm on which date the balances extracted from the books of the firm and the partners' separate estates were as follows:

	Current value Sh. '000'	Estimated value Sh. '000'
Assets		
Freehold property: Medsan Traders	11,000	12,000
Hamed	7,000	10,000
Plant and machinery: Medsan Traders	3,000	1,500
Furniture and fixtures: Medsan Traders	1,000	800
Hamed	1,500	1,200
Hassan	1,800	1,500
Inventory Medsan Traders	8,000	6,500
Accounts receivable: Medsan Traders	12,000	See (note 1)
Investments: Hamed	1,500	2,400
Hassan	2,000	1,900
Liabilities		
Mortgage on freehold property: Medsan Traders	6,000	
Hamed	5,000	
Bank overdraft: Medsan Traders	7,000	
Accounts payables: Medsan Traders	19,000	
Hamed	700	
Hassan	2,400	

Additional Information:

1. Of the accounts receivable. Sh.9 million is estimated to be good while Sh.1 million is estimated to be bad. 50% of the remaining debts are expected to be paid.
2. The preferential accounts payables for Medsan Traders, Hamed and Hassan were Sh.1,100,000. Sh.300,000 and Sh.500,000 respectively.
3. Medsan Traders bank overdraft was secured by a second mortgage on the partnership freehold property and by the deposit of Hamed's investments together with his personal guarantee.

Required:

Using the format laid down in the Bankruptcy Act (Cap 53) and showing the legal position in relation to the double proof. Prepare

- a) Statement of affairs as at 31 December 2004. (10 marks)
 - b) Deficiency or surplus accounts as at 31 December 2004 (10 marks)
- (Total:20 marks)**

QUESTION FIVE

- a) Briefly explain the following terms as used in trust and executorship accounting:
 - i) Life tenant (2 marks)
 - ii) General legacy (2 marks)
 - iii) Demonstrative legacy (2 marks)
- b) The will of Apollo Matalanza, who died on 23 January 2004, contains the following provisions:

I leave my house and personal effects to my wife Joan Matalanza
 I leave Sh.9,000 in cash to my son Yacobo Matalanza
 I leave all my investments to Chuo Kikuu
 Any income earned on my investments prior to distribution, I leave to my priest Father Tony Christopher.
 I leave the remainder of my estate to Raphael Juma

Additional Information:

1. The executor, Kamau Otieno, took an inventory of the assets of the testator and determined their fair value at the time of Apollo Matalanza's death to be as follows:

	Sh.
Cash	40,000
Household an personal effects	310,000
Investments:	
Stocks	21,000
Bonds	44,000

Land (rental property)	65,000
Antiques	19,000
Dividend receivable	1,000
Interest receivable	2,000
Rent receivable	<u>4,000</u>
	<u>512,000</u>

2. The following Valid claims were made against the estate and paid by the executor:

	Sh.
Funeral expenses	17,000
Executor charges	9,000
Medical expenses	11,000
Debts	5,000

3. The following cash collections were received by the estate

	Sh.
Dividend	2,000
Interest	3,000
Rent	7,000
Sale of antiques	21,000

4. Prior to 25 June the date the charge and discharge statement was prepared, the executor had made complete distribution to both Joan Matalanza and Yacobo Matalanza.

Required:

A charge and discharge statements for the estate of Apollo Matalanza.

(14 marks)

(Total: 20 marks)

JUNE 2005

QUESTION ONE

- (a) Computation of bond and ordinary shares to be issued to partners:

Determine the opening capital balances as 1 April 2004.

	Jembe Shs. '000'	Panga Shs. '000'	Partnership Shs. '000'
Assets less liabilities to partnerships	2,000	1,500	3,500
Freehold property	2,000	1,500	3,500
Plant and equipment	6,500	5,500	12,000
Fixtures and fittings	1,500	1,500	3,000
Inventory	1,800	350	2,150
Accounts receivable	1,900	1,000	2,900
Balance at bank	<u>300</u>	<u>150</u>	<u>450</u>
	14,000	10,000	24,000
Accounts payable	<u>(6,800)</u>	<u>4,000</u>	<u>10,800</u>
Capital balances 1.4.04	<u>7,200</u>	<u>6,000</u>	<u>13,200</u>

Compute the capital balances as at 31 March 2005 before conversion takes place.

	Jembe Shs. '000'	Panga Shs. '000'
Capital balance as at 1.1.04	7,200	6,000
Profit for year		
(Net assets as at 31.3.05 – Total capital b/f + Drawings)		
(14,350 – 13,200 + 2,390 + 610) = Sh. 4,150		
Share in PSR 3:2	<u>2,490</u>	<u>1,660</u>
	9,690	7,660
Less drawings:	<u>(2,390)</u>	<u>(610)</u>
Capital balance at 31.3.05	<u>7,300</u>	<u>7,050</u>
 Bond to be issued		
	Sh. '000'	Sh. '000'
Capital balance as at 31.5.05	7,300	7,050
Add Revaluation gain		
(6,000 + 5,670 – 4,000 – 6,420)1,250		
Share in PSR 3:2	<u>750</u>	<u>500</u>
Updated capital balances	<u>8,050</u>	<u>7,550</u>
6% rate of return	<u>483</u>	<u>453</u>
15% Bond to be issued	<u>483</u>	
	0.15	
	<u>3,220</u>	<u>3,020</u>

Revaluation a/c

	Jembe	Panga		Jembe	Panga
Plant & Equipment	300	100	Freehold property	500	500
Fixtures	100	50			
Capital-surplus	<u>100</u>	<u>350</u>			
	<u>500</u>	<u>500</u>		<u>500</u>	<u>500</u>

Capital A/C

	Jembe	Panga		Jembe	Panga
Bal c/d	<u>7,200</u>	<u>6,000</u>	Bal b/d	7,100	5,650
	<u>7,200</u>	<u>6,000</u>	Revaluation	<u>100</u>	<u>350</u>
				<u>7,200</u>	<u>6,000</u>

Net profit for the year

Change in capital = profit

Capital bal as at 31/3/05	14,350
Less: opening capital	<u>13,200</u>
Change in capital	<u>1,150</u>
Add: Drawings	<u>3,000</u>
Profit for the year	<u>4,150</u>
Profit share Jembe	<u>2,490</u>
	<u>1,660</u>

	Jembe	Panga	Total
Capital employed	7,200	6,000	13,200
Bal b/d	2,490	1,660	4,150
Add: share of profit	750	500	1,250
Add: revaluation	<u>(2,390)</u>	<u>(610)</u>	<u>(3,000)</u>
Less: drawings	<u>8,050</u>	<u>7,550</u>	<u>15,600</u>
Debentures issued	<u>3,220</u>	<u>3,020</u>	<u>6,240</u>
Shares	3,900	2,600	6,500

Shares to be issued:

	Jembe Sh. '000'	Panga Sh. '000'
Total per value		
130,000 x 50 = Sh. 6,500,000		
Based on PSR 3:2	<u>3,900,000</u>	<u>2,600,000</u>

(12 Marks)

(b) Partners capital account as at 31 March 2005

Capital account

	J Sh. '000'	P Sh. '000'		J Sh. '000'	P Sh. '000'
Drawings	2,390	610	Balance b/d	7,200	6,000
Bond	3,220	3,020	Profit	2,490	1,660
Share capital	3,900	2,600	Revaluation		
Bank	930	1,930	Gain	750	500
	<u>10,440</u>	<u>8,160</u>		<u>10,440</u>	<u>8,160</u>

(3 marks)

(c)

Shamba Ltd**Statement of financial position as at 31 March 2005**

	Sh. '000'	Sh. '000'
Non current assets		
Freehold property		6,000
Plant and equipment		13,000
Fixtures and fittings		<u>3,000</u>
		22,0000
Current assets		
Inventory	3,350	
Accounts receivable	5,670	
Bank	<u>125</u>	<u>9,145</u>
Total assets		<u>31,145</u>
Share capital		6,500
Non current liabilities		
15% Bond		6,240
Current liabilities		
Accounts payable	9,920	
Bank overdraft	<u>8,485</u>	<u>18,405</u>
		<u>31,145</u>

(5 Marks)

(Total: 20 marks)

WORKINGS

(ii) Bank overdraft

	Sh. '000'
Balance as at 31 May 2005	(5,625)
Less: Jembe	930
Panga	<u>1,930</u>
	<u>8,485</u>

QUESTION TWO

Lusiola Group
Consolidated Statement of financial position as at 31 March 2004

	Sh. '000'	Sh. '000'
Non current assets:		
Property		45,840
Goodwill (4,800 – 800)		800
Investments		8,800
Current assets:		
Inventory (13,500 + 600 – 100)	14,000	
Receivables (7,200 + 1,500 – 2,000)	6,700	
Cash and Bank	<u>300</u>	<u>21,000</u>
		<u>76,440</u>
Equity & Liabilities:		
Equity shares(ord. shares)		10,000
Accumulations profits		34,510
Minority interest		1,130
Dividends		<u>1,000</u>
		<u>46,640</u>
Non-current liabilities:		
12% debentures		10,000
Current liabilities:		
Payables (6,700 + 5,200 – 1,460)		10,500
Overdraft		4,500
Tax		<u>4,800</u>
		<u>19,800</u>
		<u>76,440</u>

(Total: 20 marks)

WORKINGS:

(1)	Property Plant & Equipment	
		Sh. '000'
	Lusialo	26,400
	Kacheliba	16,200
	Revaluation	5,400
	Depreciation additional (2 years)	<u>(2,160)</u>
		<u>45,840</u>
	Investments	
	Lusialo	1,000
	Kacheliba	6,000
	Revaluation 90% (8,000 – 6,000)	<u>1,800</u>
		<u>8,800</u>

(2)	Inventory	
	Total 9,500 + 4,000	13,500
	Add: Goods in transit $(600 \times \frac{100}{120})$	<u>500</u>
		<u>14,000</u>

(3)

Cost of control			
	Sh. '000'		Sh. '000'
Cost	30,000	Shares 90%	4,500
		Profit	13,500
		Revaluation	7,200
		Pre-acq div.	3,600
		Goodwill	<u>1,200</u>
	<u>30,000</u>	P	<u>30,000</u>

(4)

MI

Ordinary shares =	5,000 x 10%	=	500
Retained earnings =	6,300 x 10%	=	<u>630</u>
			<u>1,130</u>

(5)

P & L (W)			
	Shs.		Shs.
K-Post-Acq. Loss 8,700 x 90%	7,830	Lusialo bal b/d	48,600
UPCS	100		
Dep. Adj	2,160		
Pre-Acq. Div	3,600		
Goodwill w/o	<u>1,466</u>		
	<u>48,600</u>		<u>48,600</u>

QUESTION THREE

(a)

JAMILA TRADERS
Income Statements
For the year ended 30 September 2004

	NANYUKI Shs.	THIKA Shs.	COMBINED Shs.
Sales	13,000,000	9,202,200	22,202,200
Goods sent to branch (Less: lost in transit)	<u>6,387,330</u>	-	-
	<u>19,387,330</u>	<u>9,202,200</u>	<u>22,202,200</u>
Less: Cost of sales			
Opening stock	2,595,000	1,552,500	3,945,000
Purchases/Goods received	<u>13,626,600</u>	<u>6,387,330</u>	<u>13,626,600</u>
	<u>16,221,600</u>	<u>7,939,830</u>	<u>17,571,600</u>
Less: Cost of goods lost	82,500	-	82,500
Closing stock	<u>834,900</u>	<u>2,932.5</u>	<u>837,450</u>
Cost of sales	<u>15,304,200</u>	<u>7,936,897.5</u>	<u>16,651,650</u>

Gross profit	4,083,130	1,265,302.5	5,550,550
Add: Realised profit	202,117.5	-	-
Less: Expenses			
Goods lost (not claimed)	12,375		12,375
Rent and rates	395,400	197,250	592,650
Salaries and wages	851,700	487,500	1,339,200
General expenses	1,887,750	1,258,950	3,146,700
Depreciation	77,950	23,050	101,000
Staff bonus $(1,060,072.5 \times \frac{10}{100})$	<u>96,370</u>	<u>-</u>	<u>96,370</u>
Net profit	963,702.5	(701,447.5)	<u>262,255</u>
	<u>(701,447.5)</u>	<u>701,447.5</u>	
Net profit c/d	<u>262,255</u>		

(12 marks)

(b)

JAMILA TRADERS
Statement of financial position
As at 30 September 2004

ASSETS	COMBINED
Non Current Assets	Shs.
Buildings	3,500,000
Furniture & fittings	909,000
Branch current account	-
Less: prov for unrealized profit	<u>-</u>
	4,409,000
Current Assets	
Stock	837,450
Accounts receivable	1,300,500
Insurance claim receivable	70,125
Cash in Transit	71,250
Cash at Bank	<u>687,050</u>
	2,966,375
Less: Current Liabilities	
Accounts payable	1,509,200
Bank overdraft	250,000
Bonus payable	<u>96,370</u>
	<u>1,855,570</u>
Net Current Assets	<u>1,110,805</u>
	<u>5,519,805</u>
Financed by:	
Capital	6,040,925
Net profit	<u>262,255</u>
	6,303,180
Less: Drawings	<u>783,375</u>
	<u>5,519,805</u>

(8 Marks)

(Total: 20 Marks)

Provision for Unrealised Profits

Shs.		Shs.	
P & L (Realised)	202,117.5	Balance b/d	202,500
Balance c/d	<u>382.5</u>		
	<u>202,500.0</u>	Balance b/d	<u>202,500</u>
			382.5

Branch Current Account

Shs.		Shs.	
Balance b/d	8,931,555	Remittances	7,548,750.0
		Stock lost	94,875.0
		Cash in transit	71,250.0
		Branch loss	701,447.5
		Balance c/d	<u>515,232.5</u>
	<u>8,931,555</u>		<u>8,931,555.0</u>
Balance b/d	515,232.5		

Head Office Current Account

Shs.		Shs.	
Remittances	7,620,000.0	Balance b/d	8,836,680.0
Branch loss	701,447.5		
Bal c/d	<u>515,232.5</u>		
	<u>8,836,680.0</u>	Balance b/d	<u>8,836,680.0</u>
			515,232.5

SELECTED WORKINGS

- Depreciation

Head office:	$779,500 \times 10\% =$	77,950
Branch:	$230,500 \times 10\% =$	23,050
- Insurance claim

Cost of Goods	$= 94,875 \times \frac{100}{115} =$	82,500
---------------	-------------------------------------	--------
- Loss: $15\% \times 82,500 = 12,375$
- Cost of Closing Stock::

Head office		
Opening stock at cost		2,595,000
Purchases		<u>13,626,600</u>
Goods available for sale		16,221,600
Less: Goods to Branch:		
	$(6,482,205 \times \frac{100}{115})$	(5,636,700)
Sales ($13,000,000 \times \frac{3}{4}$)		<u>(9,750,000)</u>
Closing stock at cost.		<u>834,900</u>

Branch:		
Opening Stock		1,552,500
Goods received		<u>6,387,330</u>
		7,939,830
Less: Cost of sales		
	$\left(9,202,200 \times \frac{3}{4} \times \frac{115}{100}\right)$	<u>(7,936,897.5)</u>
	Closing stock at mark up	<u><u>2,932.5</u></u>
(5)	Combined stock::	Shs.
	Head office	834,900
	Branch: $\left(2,932.5 \times \frac{100}{115}\right)$	<u>2,550</u>
		<u>837,450</u>

QUESTION FOUR**Medsan Traders****Statement of affairs as at 31/12/04**

	Jani estate Shs. '000'	Hamed Shs. '000'	Hassan Shs. '000'		Jani estate Shs. '000'	Hamed Shs. '000'	Hassan Shs. '000'
Unsecured creditors	17,900	400	1,900	Plant & machinery	1,500	-	-
Fully secured creditors	6,000	5,000	-	Furniture & fixtures	800	1,200	1,500
Less value of security	<u>12,000</u>	<u>10,000</u>	-	Inventory	6,500	-	-
Surplus to below/contra	<u>6,000</u>	<u>5,000</u>	-	Accounts receivable	10,000	-	-
Partly secured creditors	7,000	7,000	-	Investments	-	-	1,900
Less value of security	<u>(6,000)</u>	<u>(2,400)</u>	-	Surplus from fully secured creditors	-	5,000	-
Deficiency ranking as unsecured	1,000	4,600	-	Available to preferred unsecured credit	18,800	6,200	3,400
Preferential creditors deducted as per contra	1,100	300	500	Less: preferential creditors deducted per contra	<u>(1,100)</u>	<u>(300)</u>	<u>(1,800)</u>
Surplus to partnership		300	900	Available to unsecured creditors.	17,700	5,900	2,900
Surplus as per surplus a/c		600	100	Surplus from partners – H	300		
				- Hasan	900		
	18,900	5,900	2,900		18,900	5,900	2,900

Deficiency/Surplus

	Medsan Shs. '000'	Hamed Shs. '000'	Hassan Shs. '000'		Medsan Shs. '000'	Hamed Shs. '000'	Hassan Shs. '000'
Estimated excess of assets over liabilities	3,000	5,050	3,650	Unrecorded liability-loss on guarantee of overdraft	-	7,000	-
Estimated gain on realization - prop	1,000	3,000	-	Estimated loss on realization			
- investments	-	900	-	- Plant & machine	1,500	-	-
Surplus from partners – Hamed	300	-	-	- Furniture & fittings	200	300	300
- Hassan	900	-	-	- Inventory	1,500	-	-
				- Receivables (12-10)	2,000	-	-
				- Other investments	-	-	100
				Loss of partnership capital	-	750	2,250
				Surplus and partnership	-	300	900
				Surplus as per SOA	-	600	100
	5,200	8,950	3,650		5,200	8,950	3,650

Workings:

1. Unsecured creditors

	Medsan Shs. '000'	Hamed Shs. '000'	Hassan Shs. '000'
Accounts payable	19,000	700	2,400
Less: preferential creditors	<u>(1,100)</u>	<u>(300)</u>	<u>(500)</u>
	<u>17,900</u>	<u>400</u>	<u>1,900</u>

2. Fully secured creditors

	Medsan	Hamed	Hassan
Mortgage on freehold property	6,000	5,000	-
Less: value of security	<u>(12,000)</u>	<u>(10,000)</u>	<u>-</u>
	<u>6,000</u>	<u>5,000</u>	<u>-</u>

To partly secured
CreditorsTo assets estimated
To realize

3. Partly secured creditors

	Medsan	Hamed	Hassan
Bank overdraft	7,000	7,000	-
Less value of security	<u>(6,000)</u>	<u>(2,400)</u>	<u>-</u>
Deficiency ranking as unsecured	<u>1,000</u>	<u>4,600</u>	<u>-</u>

4.	A/C receivables		
	Good debtors	=	9M
	Bad debtors	=	1M
			10M

$$\begin{aligned} \text{Total} &= 12\text{M} - 10\text{M} = 2\text{M (doubtful)} \times \frac{50}{100} \text{ (expected to be paid)} \\ &= 1\text{M} \\ \text{Total debtors expected} &= 9\text{M} + 1\text{M} = 10\text{M} \end{aligned}$$

5.							
	Joint		Hamed		Hassan	(Double proof)	
Def	(1,200)	Surp	900	Surp	1,000		
	300	PSR	(300)		(900)		
	900		<u>600</u>		<u>100</u>		
	-						

Excess of assets over liabilities

	Partnership Shs. '000'	Hamed Shs. '000'	Hassan Shs. '000'
Assets			
Freehold property	11,000	7,000	-
Plant and machinery	3,000	-	-
Furniture and fixtures	1,000	1,500	1,800
Inventory	8,000	-	-
Account receivables	12,000	-	-
Investments – in partnership	-	150	2,250
- Private	-	1,500	2,000
	35,000	10,750	6,050
LIABILITIES			
Mortgage on property	(6,000)	(5,000)	-
Bank overdraft	(7,000)	-	-
Accounts payables	<u>(19,000)</u>	<u>(700)</u>	<u>(2,400)</u>
CAPITAL	<u>3,000</u>	<u>5,050</u>	<u>3,650</u>

NOTE:

The excess of assets over liabilities in the partnership of Shs. 3 represents the combined capital of Hamed and Hassan. The example does not give the breakdown of how much has been contributed by each partner and thus we will assume that the capital has been contributed in their profit sharing ratio.

$$\therefore \text{Hamed} = \frac{1}{4} \times 3,000 = 750$$

$$\text{Hassan} = \frac{3}{4} \times 3,000 = 2,250$$

QUESTION FIVE

- (a) (i) **Life tenant:** the person, normally the wife, who will receive the benefits of the trust fund until her death. (2 Marks)
- (ii) A gift that does not come from a designated source is known as a **general legacy**. It may also be said to be a testamentary gift, whether specific or general of property described in general terms to be provided out of the general estate of the testator. (2 Marks)
- (iii) A conveyance of gift that is to be derived from a specified source is known as a **demonstrative legacy**. It may also be said to be a testamentary gift which is in its

nature general but which manifests an intention that the gift shall be primarily satisfied out of a specific part of the property of the testator, or upon failure of that fund or property, be met from the general estate. (2 marks)

Estate of Apollo Matalanza
Charge and Discharge Statement
January 23, 2004 – June 25, 2004
Kamau Otieno, Executor

AS TO PRINCIPAL

	Shs.	Shs.	Shs.
I CHARGE MYSELF WITH:			
Assets per original inventory			512,000
Gain on sale of antiques			<u>2,000</u>
Total charges			514,000
I CREDIT MYSELF WITH			
Debts of decedent:			
Medical expenses	11,000		
Other debts	<u>5,000</u>	16,000	
Funeral and admin expenses		26,000	
Legacies distributed:			
Joan Matalanza (house and personal effects)	310,000		
Yacobo Matalanza (Cash)	<u>9,000</u>	<u>319,000</u>	
Total credits			<u>(361,000)</u>
Estate principal			<u>153,000</u>
ESTATE PRINCIPAL			
Cash (see working below)			23,000
Investments:			
Stocks			21,000
Bonds			44,000
Land			<u>65,000</u>
Estate principal			<u>153,000</u>
CASH BALANCE			
Beginning balance			46,000
Sale of antique			21,000
Collection of receivables (dividends 1,000 interest 2,000 and rent 4,000)			7,000
(Funeral expenses 17,000, executor charges 9,000 medical expenses 11,000 and debts 5,000)			<u>(42,000)</u>
Legacy distribution (Yacobo Matalanza)			<u>(9,000)</u>
Cash balance			<u>23,000</u>

AS TO INCOME

I CHARGE MYSELF WITH:

	Shs.
Dividend income	
(2,000 collection less 1,000 receivable at death)	1,000
Interest income (3,000 less 2,000)	1,000
Rent income (7,000 less 4,000)	<u>3,000</u>
Balance as to income	<u>5,000</u>
Balance as to income:	
Cash	<u>5,000</u>

DECEMBER 2005

QUESTION ONE

Soma Ltd

Income Statement for the year ended 31 October 2005

	Sh. '000'	Sh. '000'
Revenue		
Cost of Sales		1,574,500
Gross Profit		<u>(886,478)</u>
		(688,022)
Expenses		
Distribution costs	127,062	
Administration expenses	246,086	
Finance costs	<u>92,460</u>	<u>(465,608)</u>
Profit before tax		222,414
Income tax expense (85,000 – 2,500)		<u>(82,500)</u>
Profit for the year		<u><u>139,914</u></u>

Soma Ltd

Statement of changes in equity (extract)

	Retained Profits
	Sh. '000'
Balance as at 1.1.2004	119,046
Correction of error (additional depreciation)	<u>(27,000)</u>
Balance as restated	92,046
Profit for the period	139,014
Purposed dividend	<u>(21,000)</u>
Balance as at 31.10.2005	210,960

Soma Ltd**Statement of financial position as at 31 October 2005**

Non current assets	Sh. '000'	Sh. '000'
Property, plant and equipment		715,750
Intangible assets		<u>96,000</u>
		811,750
Current assets		
Inventory	111,100	
Accounts receivables	159,714	
Cash	<u>100</u>	<u>270,914</u>
Total assets		<u>1,082,664</u>
Ordinary share capital		60,000
Retained profits		<u>210,960</u>
Shareholders funds		270,960
Non current liabilities		
12½ Debentures	200,000	
Bank loan	<u>240,000</u>	440,000
Current liabilities		
Bank loans (including overdraft)	80,754	
Accounts payable	139,950	
Current tax	130,000	
Proposed dividends	<u>21,000</u>	<u>371,704</u>
Total equity and liabilities		<u>1,082,664</u>

Notes to the Accounts**NOTE 1: ACCOUNTING POLICIES**

- (i) Financial statements have been prepared under the historical cost basis of accounting in accordance with the applicable international financial reporting standards.
- (ii) Property, Plant and equipment is stated as cost less the accumulated depreciation. Depreciation is provided at the following rates:

Asset	Rate
Land	Nil
Buildings	2% on cost
Plant and equipment	15% on cost
Office equipment	10% on reducing balance

- (iii) Inventory is stated in the accounts at the lower of cost and net realizable value.

NOTE 2: PROFIT FOR THE PERIOD

The profit for the period is arrived at after charging the following expenses;

	Sh. '000'
Depreciation	56,972
Amortisation	24,000
Director remuneration	714
Employee benefits	238,006

NOTE 3: PROPERTY PLANT AND EQUIPMENT

Cost/valuation	Land	Buildings	Plant	Office Equipment	Total
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
Balance at 1.11.2004	350,000	150,000	200,000	107,722	807,722
Additions	-	-	100,000	-	100,000
Balance at 31.10.2005	<u>350,000</u>	<u>150,000</u>	<u>300,000</u>	<u>107,722</u>	<u>907,722</u>

Depreciation

Balance as at 1.11.2004	-	-	90,000	18,000	108,000
Provisions for previous years	-	27,000	-	-	27,000
Charge for the year	-	<u>3,000</u>	<u>45,000</u>	<u>8,972</u>	<u>56,972</u>
Balance as at 31.10.2005	-	<u>30,000</u>	<u>135,000</u>	<u>26,972</u>	<u>191,972</u>

Net book value:

As at 31.10.2005	<u>350,000</u>	<u>120,000</u>	<u>165,000</u>	<u>80,750</u>	<u>715,750</u>
As at 31.10.2004	<u>350,000</u>	<u>150,000</u>	<u>110,000</u>	<u>89,722</u>	<u>699,722</u>

Workings:

(i) Cost of sales

	Shs. '000'
Per trial balance	670,396
Depr: Property	3,000
Plant	45,000
Amortisation	24,000
Office equipment	8,972
Write down of inventory	9,600
Factory wages	<u>125,510</u>
	<u>886,478</u>

(ii)**Finance Costs**

	Sh. '000'
Per trial balance	79,960
Debenture interest	<u>12,500</u>
	<u>92,460</u>

(v)

	Sh. '000'
Current tax in B/S	45,000
Previous years (as agreed)	<u>85,000</u>
Current year's estimate	<u>130,000</u>

(ii) Distribution costs

	Shs. '000'
Per trial balance	86,560
Increase in provision for debts	7,786
Warehouse	<u>32,716</u>
	<u>127,062</u>

(iii) Administration expenses

	Shs. '000'
Per trial balance	165,592
Office salaries	79,780
Directors' remuneration	<u>714</u>
	<u>246,086</u>

(v) Income tax expense

	Sh. '000'
Current year estimate	85,000
Previous year's over provision	<u>(2,500)</u>
	<u>82,500</u>

QUESTION TWO

Hipa Group

Cash Flow Statement for the year ended 30.9.2005

Cash flows from operating activities	Sh. million	Sh. million
Profit before tax	870	
Adjustments		
Amortisation of other intangibles	130	
Goodwill (200 – 180)	20	
Depreciation of property, plant and equipment	320	
Finance costs	<u>30</u>	
Loss on sale of plant	<u>50</u>	
	1,420	
Changes in working capital		
Increase in inventory (1420 – 940)	(480)	
Increase in receivables (990 – 780)	(310)	
Increase in accounts payable (875 – 730)	<u>145</u>	
Cash generated from operations	775	
Interest paid (30 – (15 + 5))	(20)	
Income tax paid	<u>(130)</u>	
Net cash from operating activities		625
Cash flows from investing activities		
Purchase of property, plant and equipment	(250)	
Additional intangible assets	(500)	
Proceeds on sale of plant	20	
Dividends from associates (80 + 20 – 95)	<u>5</u>	
Net cash used in investing activities		(725)
Cash flows from financing activities	Shm	Shm
Proceeds from issue of shares at a provision	450	
Issue of loan notes (300 – 100)	200	
Repayment of loan	(40)	
Dividends: Holding Co. 2004 Final + 2005 interim)	(320)	
Minority Interest (100 + 40 – 135)	<u>(5)</u>	
Net cash received from financing activities		<u>285</u>
Net increase in cash and cash equivalent		185
Cash and cash equivalent b/f		<u>(115)</u>
Cash and cash equivalent c/f		
Cash and cash equivalent		<u>70</u>
	B/f	C/f
	Shm	Shm
Cash	-	70
Bank overdraft	<u>(115)</u>	<u>-</u>
	<u>(115)</u>	<u>70</u>

Workings:**(i) Amortisation of intangibles**

	Shm
Bal B/f	100
Addition	500
Bal. c/d	<u>(470)</u>
Amortisation	<u>130</u>

(ii)

	Shm
Tax paid	
B/f: Current tax	160
Deferred tax	140
Change to P & L	270
Bal. c/f current tax	<u>(130)</u>
Deferred tax	<u>(310)</u>
Cash paid	<u>(130)</u>

(ii) Property, plant and equipment

	Shm
Bal b/f	1,830
Revaluation surplus	200
Plant bought	250
Depreciation	(320)
Bal c/d	<u>(1,890)</u>
Diffence (NBV of disposal)	<u>70</u>
Disposal: NBV	70
Loss	<u>(50)</u>
Cash received	<u>20</u>

(iv)

	Shm
Share capital	
Bal b/d	(500)
Bonus issue	<u>(50)</u>
Bal. c/d	<u>750</u>
Cash received	200
Plus share premium (350 – 100)	<u>250</u>
	<u>450</u>

QUESTION THREE**(a) Kampala Branch Translated Trial Balance**

	Ush '000'	Ush. '000'	Rate	Ksh. '000'	Kshs. '000'
Cash at bank	130,000		13	10,000	
Accounts receivable	260,000		13	20,000	
Inventory – 30 June 2005				7,160	
Accounts payable		65,000	13		5,000
Head office – current		96,000	-		50,000
Sales		1,600,000	10		160,000
Cost of goods sold	930,000		10	93,000	
Operating expenses	360,000		10	36,000	
Exchange loss	-			48,840	
	<u>1,761,000</u>	<u>1,761,000</u>		<u>215,000</u>	<u>215,000</u>

Workings

	Ush. '000'	Rate	Kshs. '000'
Value of closing stock			
Received from Head Office	24,600	10 Ush/Ksh.	2,460
Purchase locally	<u>56,400</u>	12 Ush/Ksh.	<u>4,700</u>
	<u>81,000</u>		<u>7,160</u>
Head office current a/c			
Balance per head office records			15,000
Add debtors received by branch			<u>35,000</u>
			<u>50,000</u>

Unrealised profit

Goods from head office	2,460
Cost = $\frac{2,460}{1.25}$	<u>(1,968)</u>
UPCS	<u><u>492</u></u>

Beta (EA) Ltd

Trading, profit and loss account
For the year ended 30 November 2005

	Head office	Branch	Combined
	Sh. '000'	Sh. '000'	Sh. '000'
Sales	390,000	160,000	550,000
Goods sent to branch	<u>30,000</u>	<u>-</u>	<u>-</u>
	<u>420,000</u>	<u>160,000</u>	<u>550,000</u>
Cost of sales	280,000	93,000	373,000
Less: goods from H/O			<u>(30,000)</u>
			<u>343,000</u>
Gross profit	<u>140,000</u>	<u>67,000</u>	<u>207,000</u>
Unrealised profit	<u>(492)</u>	<u>-</u>	<u>(492)</u>
	<u>139,508</u>	<u>67,000</u>	<u>206,508</u>
Expenses			
Exchange loss	-	48,840	48,840
Operating expenses	67,000	39,000	106,000
Depreciation			
Plant and equipment	10,000	5,000	15,000
Motor vehicles	<u>10,000</u>	<u>-</u>	<u>10,000</u>
Net profit	<u>52,508</u>	<u>(25,840)</u>	<u>(26,668)</u>

Beta (EA) Ltd

Statement of financial position as at 30 November 2005

Equipment	135,000
Motor vehicles	<u>40,000</u>
	<u>175,000</u>
Current assets	
Inventories	46,668
Accounts receivable	30,000
Bank	<u>16,000</u>
	<u>267,668</u>
Equity and liabilities	
Share capital	192,000
Profit and loss	26,668
Current liabilities	
Accounts payable	<u>49,000</u>
	<u>267,668</u>

QUESTION FOUR

Business Purchase Account

	KUNI LTD Shs. '000'	MOTO LTD Sh. '000'		KUNI LTD Sh. '000'	MOTO LTD Sh. '000'
Bank overdraft	44,750		Land & Buildings	93,250	-
Creditors	77,000	13,000	Furniture	2,500	-
Loan	3,600	2,400	Cash	250	-
Purchase consideration	142,650	114,550	Debtors	32,000	54,000
			Stock	115,000	56,250
			Goodwill	<u>25,000</u>	<u>20,000</u>
	<u>268,000</u>	<u>130,250</u>		<u>268,000</u>	<u>130,250</u>

Partners Capital Accounts

	KUNI LTD Sh. '000'	MOTO LTD Sh. '000'		KUNI LTD Sh. '000'	MOTO LTD Sh. '000'
Shares in Kuni Ltd	118,750	23,900	Balance b/d	131,500	81,000
Shares in Moto Ltd	<u>35,250</u>	<u>79,600</u>	Goodwill	<u>22,500</u>	<u>22,500</u>
	<u>154,000</u>	<u>103,500</u>		<u>154,000</u>	<u>103,500</u>

Vendors Account

	Sh. '000'		Shs. '000'
Ord. Shares in Kuni Ltd.	142,650	Business Purchases A/C	
Ord. Shares in Moto Ltd.	114,850	Kuni Ltd.	142,650
		Moto Ltd.	<u>114,850</u>
	<u>257,500</u>		<u>257,500</u>

Bank Account

	KUNI LTD Sh. '000'	MOTO LTD Sh. '000'		KUNI LTD Sh. '000'	MOTO LTD Sh. '000'
12% Debentures	50,000		Balance b/d	44,750	
Issue of shares B Ltd & C Ltd (Share application)	5,000	7,500	Debenture expense	1,750	
			Preliminary exp	3,250	2,000
			Balance c/d	<u>5,250</u>	<u>5,500</u>
	<u>55,000</u>	<u>7,500</u>		<u>55,000</u>	<u>7,500</u>

OPENING STATEMENT OF FINANCIAL POSITION

ASSETS	Kuni Ltd.		Moto Ltd.	
	Shs.	Shs.	Shs.	Shs.
Non current assets				
Land and buildings		93,250		
Furniture		<u>2,500</u>		
		95,750		
Intangible assets				
Goodwill		25,000		20,000
Establishment costs		3,250		2,000
Debenture expenses		<u>1,750</u>		<u>-</u>
		30,000		22,000
Current assets				
Cash	250		-	
Bank	5,250		5,500	
Debtors	32,000		54,000	
Stock	<u>115,000</u>		<u>56,250</u>	
	<u>152,500</u>		<u>115,750</u>	
Less: Current liabilities				
Creditors	77,000	75,500	13,000	102,750
		201,250		124,750
Financed by:				
Share capital				
Ordinary shares of Shs. 10 each		147,650		122,350
Long term liabilities				
12% Debentures		50,000		
10% Debentures		<u>3,600</u>		<u>2,400</u>
		<u>201,250</u>		<u>124,750</u>

QUESTION FIVE

- (a) (i) Defined contribution plans – are post-employment benefits plans under which an enterprise pays fixed contribution into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employees benefits relating to employee services in the current and prior periods.
- (ii) Terminal benefits should be recognized as a liability and an expense when and only when the enterprise is demonstrably committed to either:
- (1) Terminate the employment of an employee or group of employees before the normal retirement date; or
 - (2) Provide terminal benefits as a result of an offer made in order to encourage voluntary redundancy.

(b) (i)

Treasure Motors Retirement Benefits Scheme**Statement of change in net assets for the year ended 30th June 2005**

	Kshs.	Kshs.
Members contributions		250,200
Employers contributions		<u>630,600</u>
Total contributions		880,800
Pensions and commutations		(209,000)
Withdrawals from scheme		<u>(15,000)</u>
Net additions by members		656,800
Return on investments:		
Interest on investments	<u>640,000</u>	640,000
Other expenses:		
Management expenses		<u>(7,000)</u>
Net change in net assets		1,289,800
Opening accumulated fund as at (July 2004)		<u>7,640,000</u>
Net assets at 30 June 2005		<u><u>8,929,800</u></u>

Treasure Motors Retirement Benefits Scheme**Statement of change in Net Assets for the year ended 30th June 2005**

Assets	Kshs.
Premises	800,000
Quoted shares	3,000,000
Unquoted shares	2,500,000
Government securities	590,000
Off-shares investments	1,040,000
Fixed deposits	260,000
Current deposits	32,200
Receivables from employers	635,600
Income receivable	80,000
Payable to members	<u>(8,000)</u>
Net assets as at 30 June 2005	<u><u>8,929,800</u></u>
Funded by: -	
Opening Account fund	7,640,000
Change in net assets	<u>1,289,800</u>
	<u><u>8,929,800</u></u>

**MOCK EXAMINATION
CPA PART II
FINANCIAL ACCOUNTING III**

To be carried out under examination conditions and sent to the Distance Learning Administrator for marking by the University.

Answer All Questions

Time Allowed: 3 Three Hours.

Answer all questions. Marks allocated to questions are shown at the end of questions

QUESTION ONE

Ademo Limited is a company quoted on the Nairobi Stock Exchange. It distributes a wide variety of household machinery including sewing machines. On 1 October 1997 it purchased shares in Afro clothing Limited. The group purchased shares in Piki Limited, a nation wide chain of retail shops dealing in casual wear on 1 April 1998. All the companies make up their accounts to 31 March each year.

The draft final accounts for the three companies for the year ended 31 March 2000 are as follows:

Income statement for the year ended 31 March 2000.

	Ademo Ltd Sh.m	Afro Ltd Sh.m	Piki Ltd Sh.m
Revenue	1,368	774	685
Cost of sales	<u>(810)</u>	<u>(407)</u>	<u>(355)</u>
Gross profit	558	367	330
Distribution costs	(196)	(64)	(78)
Administration expenses	(112)	(73)	(72)
Finance cost	<u>(50)</u>	<u>(20)</u>	<u>0</u>
Profit before tax	200	210	180
Income tax expense	<u>(60)</u>	<u>(60)</u>	<u>(50)</u>
Profit after tax	140	150	130
Proposed dividends	<u>(150)</u>	<u>(100)</u>	<u>(100)</u>
Retained profits for the year	(10)	50	30
Retained profits brought forward	<u>713</u>	<u>610</u>	<u>420</u>
Retained profit carried forward	<u>703</u>	<u>660</u>	<u>450</u>

Statement of financial position as at 31 March 2000	Ademo Ltd Sh.m	Afro Ltd Sh.m	Piki Ltd Sh.m
Non current assets			
Property, plant and equipment	853	415	495
Investment in Afro	602		
Investment in Piki		405	
	1455	820	495
Current assets			
Inventory	368	200	190
Trade receivables	380	230	240
Cash at bank	<u>120</u>	<u>115</u>	<u>91</u>
Total assets	<u>2,323</u>	<u>1,365</u>	<u>1,016</u>

Ordinary share capital	800	200	100
Retained profits	<u>703</u>	<u>660</u>	<u>450</u>
Shareholders funds	1,503	860	550
Non current liabilities			
10% loan stock	500	200	0
Current liabilities			
Trade payables	140	175	346
Current tax	30	30	20
Proposed Dividends	<u>150</u>	<u>100</u>	<u>100</u>
Total equity and liabilities	<u>2,323</u>	<u>1,365</u>	<u>1,016</u>

The following additional information is available:

- (i) On 1 October 1997 Ademo Ltd acquired 16 million sh.10 ordinary shares in Afro Clothing Ltd. For sh. 602 million when the retained profits of Afro Ltd was sh. 490 million.
- (ii) On 1 April 1998 Afro Ltd acquired 7.5 million sh.10 ordinary shares in Piki Ltd for sh.405 million when the retained profits of Piki Ltd amounted to sh. 300 million. On this date the leasehold property had a fair value of sh.40 million in excess of the book value and 10 years remaining on the lease. Depreciation charge on the book value of the lease is included as part of administration expenses.
- (iii) In the year ended 31 March 2000 Piki Ltd sold goods at a price of Sh.80 million. Piki Ltd had marked up these goods by 100% on cost. Afro Ltd held 50% of these goods in stock on 31 March 2000.
- (iv) In the year ended 31 March 2000 Afro ltd sold Ademo Ltd goods at a price of sh.90 million. Afro ltd had marked up these goods by 80% on cost. Ademo Ltd held 25% of these goods in stock on 31 March 2000.
- (v) On 1 April 1999 Ademo Ltd sold sewing machines to Afro Ltd for sh.150 million. Afro Ltd included these machines in its PPE and charges depreciation of 20% on cost. Ademo Ltd had marked up these items at 50% on cost. Afro ltd includes the depreciation of these machines in its cost of sales.
- (vi) On 31 March 200 all the inter company balances are in agreement with Afro Ltd owing Piki Ltd sh. 24 million and Ademo Ltd owing Afro Ltd sh.18 million.
- (vii) The group does not amortise goodwill arising on consolidation. However in the current year the management feels that half of these goodwill has been impaired. This impairment loss is to be charged as a separate item in the income statement.

Required

The consolidated income statement for the year ended 31 March 2000 and a consolidated statement of financial position as at the same date. (25 marks)

QUESTION TWO

Hapa and Kule Ltd operate a head office in Nairobi and a branch in Eldoret. Goods sent to the branch are marked up by 10% on cost. All goods sold by the branch are supplied from Head Office.

The trial balances extracted from the head –office and branch books as at 30th September 19 1, rounded to the nearest Shs.1,000 were as follows:

	Nairobi		Eldoret	
	Dr Shs. '000'	Cr Shs. '000'	Dr Shs. '000'	Cr Shs. '000'
Share Capital: Authorised, Issued and Fully Paid				
Ordinary shares of Shs.10 each		5,000	-	-
Share Premium account		1,250	-	-
Profit and Loss account		6,194	-	-
Debtors / Creditors	2,016	2,903	1,588	72
Head Office Current Account	-	-	-	4,432
Land and buildings: cost/accumulated	4,750	475	2,150	268
Depreciation as at 1 Oct 19 0				
Plant and Machinery: cost/accumulated	3,870	1,540	-	-
Depreciation as at 1 Oct 19 0				
Motor Vehicles: cost/accumulated	1,380	552	760	304
Depreciation as at 1 Oct 19 0			1,397	
Stock at 1 Oct 19 0: cost/mark-up	2,988			47
Bank	678			19,050
Sales		23,935		
Purchases/Goods from Head Office	34,834		17,061	
Administration Expenses	2,672		726	
Selling and Distribution Expenses	1,321		491	
Provision for unrealised profit on stock		127		
Branch Current Account	4,671			
Goods sent to branch		17,204		
	<u>59,180</u>	<u>59,180</u>	<u>24,173</u>	<u>24,173</u>

The following information is relevant to the preparation of the Head Office, Branch and whole business Trading and Profit and Loss Accounts for the year ended 30 September 19 1:

Stocks at 30 September 19 1 were as follows:

At Head Office, at cost	Shs.3,034,000
At Branch, at marked up price	Shs.1,694,000
In transit, at marked up price	Shs. 143,000

There was cash in transit from the branch to the head office at 30 September 19 1 of Shs.96,000.

Depreciation is to be charged at the following rates:

Land and Buildings :	2% of cost
Plant and Machinery :	10% of cost
Motor Vehicle :	20% of written down value such charge being rounded down to the nearest Shs.1,000).

Head Office administration expenses included:

Audit fees	:	Shs. 45,000
Director's fees 4 non-executive directors)	:	Shs.144,000
Directors' salaries	:	Shs.400,000
Head Office selling and distribution expenses included:		
Sales Director's salary	:	Shs.180,000

Corporation tax for the year ended 30th September 19 1 is to be provided in the amount of Shs.1,355,000.

A final dividend of 21% on the paid-up share capital has been proposed by the directors.

Required:

Prepare a columnar Trading and Profit Loss Account for internal use for the year ended 30th September 1991, which will show separately the results of the Head Office, the branch and the whole business.

(10 marks)

Prepare the Income statement for the year ended 30th September 19 1, and the statement of financial position as at

30th September 19 1 in accordance with the Companies Act and IFRS (where applicable)

(10 marks)

(Total: 20 marks)

QUESTION THREE

X, Y, Z and M are in partnership sharing profits in the ratio 3:2:1:4 respectively. It is decided to dissolve this small size partnership on 1 January 1994 on which date the statement of financial position was as below:

	Sh.	Sh.
Non current assets:		
Land and buildings		42,500
Plant and machinery		39,605
Goodwill		15,000
Investments		19,000
		107,105
Current Assets:		
Stock	31,740	
Debtors	19,205	
Cash at bank	1,565	
	52,510	
Less creditors	34,615	17,895
		125,000
Capital Accounts:		
X		35,000
Y		20,000
Z		15,000
M		20,000
Leasehold redemption fund		10,000
General reserve		25,000
		125,000

The assets are realised piecemeal as below:

		Sh.
January 11	Stock (Part)	17,500
15	Debtors (Part)	14,660
29	Investments	12,100
February 4	Goodwill	10,000
22	Land and buildings	35,000
22	Debtors (Part)	2,500
22	Stock (balance)	13,750
March 16	Plant and machinery	32,800
16	Debtors (balance)	1,755

Subject to providing Sh.2,500 to meet the probable expenses of realisation, the partners decide that after the creditors have been paid, all cash received shall be divided between them immediately.

The expenses of realisation, which are paid on 16 March amounts to Sh.2,000.

Required:

- (a) Prepare a statement showing how the distributions should be made. (10 marks)
- (b) Prepare a realisation Profit and Loss Account, Cash Account and the Partners Capital Accounts. (10 marks)

QUESTION FOUR

Ted Safari has had a bankruptcy petition filed against him in the High Court. A receiving order was made on 31 October 1995. He has not kept accounts for 10 months to 31 October 1995. His financial position as at 31 December 1993 (the Official Receiver has accepted that the Deficiency Account cover the period from this date) was as follows:-

Business Statement of financial position
As at 31 December 1994**Net Personal Assets****As at 31 December 1994**

Fixed assets (Net Book Value)	Sh. '000'	Sh. '000'	Assets at cost:	Sh. '000'
Plant and Machinery		4,000	House	4,000
Motor vehicles		<u>5,000</u>	Furniture and contents	300
		9,000	Motor car	<u>700</u>
				<u>5,000</u>
Current Assets:				
Stock	3,000		Mortgage on house	3,000
Debtors	<u>7,000</u>		Car loan (secured on car)	<u>500</u>
	<u>10,000</u>			<u>3,500</u>
			Value of net estate	<u>1,500</u>
Current Liabilities				
Bank overdraft (secured on plant)	3,000			
Creditors	<u>5,000</u>			
	<u>8,000</u>	<u>2,000</u>		
		<u>11,000</u>		
Capital		7,500		
Finance lease on vehicles		<u>3,500</u>		
		<u>11,000</u>		

You establish the following facts.

Between 1 January 1995 and 31 October 1995, he had made 10 monthly payments of Sh.60, 000 each in respect of his mortgage: mortgage interests for the period was Sh.500, 000. He had made 3 quarterly repayments on his car loan Sh.75, 000 each and on the finance lease on his vehicles of Sh.850, 000 each; interest for the 10 months on the car loan and finance lease were Sh.100,000 and Sh.600,000 respectively. These payments were made out of his business bank account for the 10-month period to 31 October 1995; sales (both for cash and on credit) totalled Sh.30 million. He collected and banked directly Sh.28 million from debtors and sales; he used Sh.1 million collections for drawings. All creditors at 3 December 1994 were in respect of trade purchases. In the 10 months he had paid Sh 22 million to trade creditors and Sh.5million in respect of expenses. He had neither purchased nor sold any fixed assets, either for his business or his personal use. He had obtained a short-term loan from his uncle on 29 October 1995 for Sh.5 million which he had banked in his business bank account on the same day. Overdraft interest for the period had been charged in the amount of Sh.750, 000. On 31 October 1995, stock at cost was Sh.2 million. Liabilities of Sh.6 million for purchases and Sh.1 million for expenses (including Sh.300, 000 to his 25 employees for months of September and October – all earn in excess of Sh.3, 000 per month, and Sh.260, 000 PAYE deductions not yet paid across to the Income Tax Department) need to be accounted for: The realisable value of assets are: Plant Sh.1.8 million, Motor vehicles Sh.2.5 million, Stock Sh.1.6 million, Debtors Sh.5.5 million, House Sh.4.2 million, Furniture and contents Sh.0.1 million, Motor Car Sh.0.4 million. He had drawn Sh.500, 000 from his business bank account in respect of personal expenses.

Required:

Statement of Affairs and a Deficiency Account in accordance with the format contained in the Bankruptcy Act. Show all your workings.

QUESTION FIVE

a. State two main ways of constituting a trust.

Give appropriate examples

(4 marks)

b. Five years ago Otieno bought a house in the name of his friend Odhiambo in order to conceal the ownership of the house. Odhiambo is now claiming the house as his own.

Required:

What is the position on ownership of the house? Would the position be the same if Odhiambo was Otieno's son? (6 marks)

c. An aircraft went out of control and crashed on Kimani's villa in Tena estate. Kimani and his members of the family perished in the accident. The Utopian ambassador being a kind man immediately raised a fund for the benefit of the dependants of Kimani's family.

It now appears that there are no dependants and the ambassador wishes to know how he should distribute the money he had raised for late Kimani's dependants. Explain to the ambassador the alternatives opened to him. (5 marks)

(Total: 15 marks)

END OF MOCK EXAMINATION

NOW SEND YOUR ANSWERS TO THE DISTANCE LEARNING CENTRE FOR MARKING.