CPA PART II SECTION 3

FINANCIAL REPORTING

THURSDAY: 2 September 2021. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

(a) In the context of International Accounting Standard (IAS) 10 – Events after the Reporting Period. justify your classification of the following events as either adjusting or non-adjusting events:

(i) Major business combination after the reporting period. (1 mark)

(ii) Major dealings in the company's shares. (1 mark)

(iii) Resolution of a court case against the company for damages. (1 mark)

(iv) Destruction of a major asset by fire. (1 mark)

(v) Bankruptcy of a major customer. (1 mark)

(vi) Expropriation of assets by the county government. (1 mark)

(b) The following trial balance relates to Samoa Ltd., a company in the small and medium size sector as at 30 September 2020:

		Sh."000"	Sh."000"
Investment at fair value		5,000	
Land and building (cost)		12,600	
Leased plant		10,000	
Motor vehicles (cost)		18,400	
Accumulated depreciation	- Building (1 October 2019)		2,700
	- Leased plant (1 October 2019)		2,500
	- Motor vehicles (1 October 2019)		6,400
Revenue			156,000
Cost of sales		117,250	
Inventory (30 September 2020)		20,200	
Distribution cost		9,750	
Administrative expenses		13,750	
Retained earnings (1 October 2019)			2,100
Finance lease payment		2,650	
10% loan stock			20,600
Loan stock interest paid		206	
Receivables and payables		16,400	16,700
Equity dividend paid (1 October 2019)		3,794	
Obligation under finance lease			5,500
Bank		2,750	
Ordinary share capital (Sh.50 each)			20,200
Income tax			8
Database costs		308	
Investment income			350
		233,058	233,058

Additional information:

1. The company had paid a maintenance contract of Sh.12,000,000 for 3 months from 1 September 2020. The invoice was posted on 1 September 2020 and included in cost of sales.
2. The leased plant was acquired on 1 October 2018. The rental payments are Sh.2,650,000 per annum for four years payable in arrears on 28 September each year. The interest rate implicit in the lease is 10%.
3. On checking the inventory figure, it was discovered that an item of inventory with the following valuations was omitted from the inventory valuation that had been used in the trial balance:
   - Net replacement cost Sh.40,000.
   - Net realiseable value Sh.48,000.
   - Cost Sh.45,000.
4. The database costs relate to the development of a new database for the company, which the management consider should be included as an intangible asset.
5. Included in the trial balance under land and buildings is Sh.4,000,000 for the cost of land which is not being depreciated. The land has a market value of Sh.4,800,000.
6. Depreciation is to be calculated on a yearly basis as follows:

Asset	**Basis**	**Inclusion**
Building	5% straight line	Administrative expenses
Motor vehicles	25% reducing balance	Distribution costs

7. Current year tax was estimated at Sh.3,800,000. The Sh.8,000 in the trial balance relates to an overprovision for the previous year.
8. The loan notes were issued on 1 April 2019 under an agreement that provides for repayment in 2022 at a substantial premium. The loan notes effective interest rate is 8.5% per annum.
9. Some years back, Samoa Limited gave a guarantee securing Miradi Ltd.'s overdraft. It has recently been reported that Miradi Ltd. is in financial difficulties and at the company's year end, the overdraft stood at Sh.100,000.

Required:

(i) Statement of comprehensive income for the year ended 30 September 2020. (6 marks)

(ii) Statement of financial position as at 30 September 2020. (8 marks)

(Total: 20 marks)

QUESTION TWO

Chanda Ltd. acquired 75% of the ordinary share capital of Pete Ltd. on 1 May 2020 through a share exchange of three shares of Chanda Ltd. for four shares acquired in Pete Ltd. On this date, the ordinary shares of Chanda Ltd. and Pete Ltd. were fair valued at Sh.40 and Sh.20 per share respectively.

The share exchange has not yet been recorded by Chanda Ltd.

Below are the draft financial statements for the two companies for the year ended 31 October 2020:

Statements of comprehensive income for the year ended 31 October 2020:

	Chanda Ltd. **Sh."Million"**	**Pete Ltd.** **Sh."Million"**
Revenue	28,200	8,720
Cost of sales	(12,800)	(3,240)
Gross profit	15,400	5,480
Distribution costs	(2,320)	(640)
Administrative expenses	(3,680)	(1,120)
Investment income	1,840	80
Finance costs	(480)	(560)
Profit before tax	10,760	3,240
Income tax expense	(2,060)	(600)
Profit for the year	8,700	2,640
Other comprehensive income:		
Gain on revaluation of land	112	120
Total comprehensive income	8,812	2,760

Statements of financial position as at 31 October 2020:

	Chanda Ltd. Sh."Million"	Pete Ltd. Sh."Million"
Assets:		
Non-current assets:		
Property, plant and equipment	24,360	7,560
Financial assets	8,120	2,520
	32,480	10,080
Current assets:		
Inventory	4,832	2,000
Trade receivables	4,768	1,960
Bank	3,200	1,320
	12,800	5,280
Total assets	45,280	15,360
Equity and liabilities:		
Equity:		
Ordinary share capital (Sh.10 par value)	8,000	3,200
Revaluation surplus	2,260	420
Retained earnings	26,060	4,780
	36,320	8,400
Non-current liabilities:		
10% loan stocks	2,400	3,200
Current liabilities:		
Trade payables	4,920	2,820
Current tax payable	1,640	940
	6,560	3,760
Total equity and liabilities	45,280	15,360

Additional information:

1. A fair value exercise conducted on 1 May 2020 concluded that the carrying amounts of Pete Ltd.'s net assets approximated their fair values with the exception of an item of plant and equipment which had a fair value of Sh.320 million in excess of its carrying amount.
   As at 1 May 2020, the item of plant and equipment had a remaining life of four years. Depreciation is being charged on straight-line basis to cost of sales.
2. In the post-acquisition period, Chanda Ltd. sold goods worth Sh.1,560 million to Pete Ltd. Pete Ltd. had one quarter of these goods in inventory as at 31 October 2020. All of these goods had a mark-up on cost of 30%.
3. Chanda Ltd.'s trade receivables include Sh.320 million due from Pete Ltd. which did not reconcile with the corresponding trade payables. This was due to cash paid by Pete Ltd. which had not been received by Chanda Ltd. as at 31 October 2020.
4. Chanda Ltd. has a policy of measuring the non-controlling interests at fair value. As at 1 May 2020, the non-controlling interest in Pete Ltd. were fair valued on the basis of the market price of Pete Ltd.'s ordinary shares.
5. Goodwill arising on acquisition of Pete Ltd was impairment tested on 31 October 2020 and no impairment was deemed necessary.
6. All other comprehensive income occurred after 1 May 2020. Unless otherwise indicated, all other items of incomes and expenses are deemed to accrue evenly over the year.

Required:

(a) Goodwill arising on acquisition of investment in Pete Ltd. (4 marks)

(b) Consolidated statement of comprehensive income for the year ended 31 October 2020. (8 marks)

(c) Consolidated statement of financial position as at 31 October 2020. (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) Discuss three main differences between hire-purchase and instalment sales. (6 marks)

(b) Ali, Baba and Chali are partners sharing profits and losses in the ratio of 3:2:1 respectively. The partners prepare their accounts annually to 31 December.

The statement of financial position of the partnership as at 31 December 2020 was as follows:

		Sh."000"	Sh."000"
Assets:			
Non-current assets:			
Land and building (land Sh.4,500,000)			6,000
Plant and machinery:	Cost	4,500	
	Accumulated depreciation	(1,200)	3,300
Motor vehicles:	Cost	4,800	
	Accumulated depreciated	(1,800)	3,000
Joint life policy			600
			12,900
Current assets:			
Inventory		3,000	
Accounts receivable		825	
Cash at bank		920	4,745
Total assets			17,645
Capital and liabilities:			
Capital accounts:	Ali		4,500
	Baba		3,000
	Chali		3,000
			10,500
Current accounts:	Ali	1,950	
	Baba	(375)	
	Chali	2,175	3,750
Bank loan			2,270
Accounts payable			1,125
			17,645

Additional information:

1. On 30 June 2021, the partners decided to dissolve the partnership following persistent disagreement. No drawings have been done by the partners to 30 June 2021, however, in arriving at the profit for the period ended 30 June 2021, depreciation was to be charged on a prorata basis on costs as follows:

Asset	Rate per annum
Building	2%
Plant and machinery	20%
Motor vehicles	25%

The book values of other assets and liabilities as at 30 June 2021 were as shown below:

	Sh."000"
Land	4,800
Joint life policy	600
Inventory	3,600
Accounts receivable	3,000
Cash at bank	920
Accounts payable	2,700

2. Dissolution expenses amounted to Sh.360,000 and the accounts payable were settled net of a discount of 10%.
3. Ali was to take over the only vehicle at an agreed valuation of Sh.1,520,000.
4. Other assets were realised on instalments basis as follows:

	Sh."000"
First instalment	850
Second instalment	5,000
Third instalment	6,130
Fourth instalment	4,900

Required:

(i) Statement of cash distribution. (5 marks)

(ii) Realisation account. (3 marks)

(iii) Bank account. (3 marks)

(iv) Partners' capital accounts. (3 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Darubini Ltd. has provided the following schedule of its long term loans for the year ended 31 December 2020:

	1 January 2020	31 December 2020
	Sh."000"	Sh."000"
10% loan note (2025)	300,000	300,000
12% bonds (2028)	200,000	200,000
6% debenture (2024)	60,000	60,000

Additional information:

1. The 10% loan note and 12% bonds were used to finance the construction of a power plant which commenced on 1 January 2020. Expenditure for the construction was drawn with Sh.100 million being drawn on 1 January 2020 and Sh.75 million on 1 July 2020.
2. The 6% debenture was used to finance the construction of a new storage facility. The construction commenced on 1 January 2020 but no construction took place between 1 March 2020 to 31 May 2020 due to Covid-19 restrictions. The facility was available for use on 31 December 2020 having incurred a construction cost of Sh.60 million.

Required:

In line with provisions of International Accounting Standard (IAS) 23-Borrowing Costs, determine:

(i) Borrowing costs to be capitalised for each of the projects as at 31 December 2020. (3 marks)

(ii) The value of the assets in the books of Darubini Ltd. as at 31 December 2020. (3 marks)

(b) The following trial balance was extracted from the books of Riba Insurance Ltd. as at 31 July 2021:

		Sh."000"	Sh."000"
Premiums outstanding (1 August 2020) -	Marine	8,640	
-	Fire	6,720	
Retained profits (1 August 2020)			4,320
Share premium			9.600
Ordinary share capital			28,800
Investment income			2,688
Accounts payable			3,168
Management expenses:	- Marine	6,240	
	- Fire	5,568	
Depreciation on non-current assets		8,688	
Directors remuneration		4,752	
Audit fees		2,304	
Freehold property		40,320	
Motor vehicles (net book value)		33,600	
Equipment and computers (net book value)		14,400	
Furniture and fittings (net book value)		12,480	
Financial assets		13,440	
Bad debts written off:	- Marine	1,632	
	- Fire	1,152	
Survey expenses on claims:	- Marine	1,845	
	- Fire	1,227	
Legal cost:	- Marine	1,728	
	- Fire	1,248	
Claims paid:	Marine	23,712	
	Fire	17,280	
Claims outstanding (1 August 2020)	- Marine		7,680
	- Fire		5,184
Unexpired premiums (1 August 2020)	- Marine		46,080
	- Fire		24,000
Cash and bank balances		1,056	
Accounts receivable		7,008	
Direct premiums received:	- Marine		43,200
	- Fire		33,600
Re-insurance premiums received:	- Marine		11,520
	- Fire		7,680
Re-insurance premiums paid:	- Marine	7,680	
	- Fire	4,800	
		227,520	227,520

Additional information:

1. Premium outstanding as at 31 July 2021 amounted to Sh.14,400,000 and Sh.6,400,000 for marine and fire insurance respectively.
2. Reserve for unexpected premiums should be maintained at 100% and 50% of the net premium for marine and fire insurance respectively.
3. Claims intimated and outstanding as at 31 July 2021 amounted to Sh.7,200,000 for marine and Sh.4,608,000 for fire insurance.
4. Commission on both re-insurance ceded and re-insurance accepted is at the rate of 5% of the premiums.
5. Provisions are to be made for the following:
    - Taxation Sh.4,152,000
    - Ordinary dividend of 5%
6. Depreciation comprise of:
    - Motor vehicles Sh.4,120,000
    - Equipment and computers Sh.2,168,000
    - Furniture and fittings Sh.2,400,000

Required:

(i) Marine and fire insurance revenue accounts for the year ended 31 July 2021. (5 marks)

(ii) Statement of comprehensive income for the year ended 31 July 2021. (5 marks)

(iii) Statement of financial position as at 31 July 2021. (4 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The International Financial Reporting Standard (IFRS) 9 – Financial Instruments, specifies how an entity should classify and measure financial assets, financial liabilities and some contracts to buy or sell non-financial items.

Required:

Describe the requirements of IFRS – 9 as they relate to:

(i) Initial measurement of financial assets. (2 marks)

(ii) Subsequent measurement of financial assets. (4 marks)

(iii) Debt instruments. (4 marks)

(iv) Equity instruments. (2 marks)

(b) With reference to International Public Sector Accounting Standard (IPSAS) 1 – Presentation of Financial Statements, explain the criteria for classifying an item as either:

(i) Current asset. (4 marks)

(ii) Current liability. (4 marks)

(Total: 20 marks)

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