KASNEB

CPA PART II SECTION 3

FINANCIAL REPORTING

PILOT PAPER

September 2015. **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) On 1 October 2014, P Ltd. acquired 60% of the equity share capital of S Ltd. in a share exchange of two shares of P Ltd. for three shares of S Ltd. On this date, shares of P Ltd. were trading at Sh.8 each.

Below are the financial statements for the two companies for the year ended 31 March 2015.

Income statements for the year ended 31 March 2015:

	P Ltd.	**S Ltd.**
	Sh."000"	**Sh."000"**
Revenue	170,000	84,000
Cost of sales	(126,000)	(64,000)
Gross profit	44,000	20,000
Distribution costs	(4,000)	(4,000)
Administrative expenses	(12,000)	(6,400)
Finance costs	(600)	(800)
Profit before tax	27,400	8,800
Income tax expense	(9,400)	(2,800)
Profit for year	18,000	6,000

Statements of financial position as at 31 March 2015:

	Sh."000"	**Sh."000"**
Assets		
Non-current assets		
Property, plant and equipment	60,900	18,900
Investment property	20,300	6,300
	81,200	25,200
Current assets		
Inventory	12,080	5,000
Receivables	11,920	4,900
Bank	8,000	3,300
	32,000	13,200
	113,200	38,400
Equity and liabilities		
Capital and reserves		
Ordinary share capital (Sh.1 each)	20,000	8,000
Retained earnings	70,800	13,000
	90,800	21,000
Non-current liabilities		
10% loan notes	6,000	8,000
Current liabilities		
Trade payables	12,300	7,050
Accruals	4,100	2,350
	16,400	9,400
	113,200	38,400

Additional information:

1. The issue of shares on acquisition of S Ltd. has not yet been recorded by P Ltd.

2. As at the acquisition date, fair values of S Ltd.'s assets were equal to their carrying amount except for an item of plant, which had a fair value of Sh.2 million in excess of the carrying amount. The plant had a remaining useful life 5 years as at the acquisition date. S Ltd. has not revalued its assets.
3. Sales from S Ltd. to Patterson Ltd. in the post acquisition period amounted to Sh.8 million. S Ltd. made a mark up of 40%. Sh.2.8 million of these goods at cost to P Ltd. were still included in inventory on 31 March 2015.
4. S Ltd.'s trade receivables include Sh.800,000 due from P Ltd. which did not agree with the corresponding payables. This was due to cash paid by P Ltd. which was yet to be received by S Ltd.
5. P Ltd. has a policy of accounting for any non controlling interest at fair value. Fair value of goodwill attributable to non controlling interest in S Ltd. was Sh.2.4 million.
6. Neither of the company declared dividends in the year ended 31 March 2015.

Required:

(i) Consolidated statement of comprehensive income for the year ended 31 March 2015. (10 marks)

(ii) Consolidated statement of financial position as at 31 March 2015. (10 marks)

(Total: 20 marks)

QUESTION TWO

The following trial balance relates to B Ltd. as at 30 June 2015:

	Sh."000"	Sh."000"
Leasehold property at valuation 1 July 2014	75,000	
Plant and equipment at cost	114,900	
Accumulated depreciation - plant and equipment		36,900
Capitalised development expenditure 1 July 2014	30,000	
Inventory	30,000	
Trade receivables	64,650	
Trade payables and provisions		35,700
Revenue		450,000
Cost of sales	306,000	
Distribution costs	21,750	
Administrative expenses	33,300	
Preference dividend paid	1,200	
Interest on bank borrowings	300	
Ordinary dividend paid	9,000	
Research and development costs	12,900	
Ordinary shares Sh.1 each		75,000
8% redeemable preference shares		30,000
Retained earnings		36,750
Deferred tax		8,700
Leasehold property revaluation reserve		15,000
Accumulated amortisation 1 July 2014		9,000
Bank		1,950
	699,000	699,000

Additional information:

1. Leasehold property had a remaining useful life of 30 years as at 1 July 2014. The company's policy is to revalue its property at each year end. As at 30 June 2015 the leasehold property was valued at Sh.64.5 million. On 1 July 2014, an item of plant was disposed of for Sh.3.75 million cash. The proceeds were treated as sales revenue. The plant was still included in the trial balance at cost of Sh.12 million with the accumulated depreciation of Sh.6 million. All plant is depreciated at 20% per annum using the reducing balance method. Depreciation and amortisation on all non-current assets is charged to cost of sales and amounts for the year had not been provided.
2. Ignore deferred tax on revaluation charges.
3. In addition to capitalised development expenditure in the year amounting to Sh.30 million, further research and development costs were incurred in the year on a project that commenced on 1 July 2014. The research stage of the new project lasted until 30 September 2014 taking up Sh.2.1 million of the costs. From 1 October 2014, the project's development cost Sh.1.2 million per month. On 1 January 2015 the directors established the project's technical and commercial feasibility and committed to completion of the project. The project was still under development as at 30 June 2015.
4. Capitalised development is amortised at 20% per annum on a straight line basis and expensed research is charged to cost of sales.

5. B Ltd. is being sued by a customer for Sh.3 million for breach of contract. The company has obtained legal opinion that there is a 20% chance of losing the case. Accordingly the company has provided Sh.600,000 (20% of Sh.3 million) included in administrative expenses. The irrecoverable legal costs of defending the action are estimated at Sh.150,000 and these costs have not been provided for as the legal action is not expected in court until the next financial year.
6. The redeemable preference shares were issued on 1 January 2015 and have an effective interest rate of 12%.
7. Income tax should be provided for the year at Sh.17.1 million and the required deferred tax liability is Sh.9 million.

Required:
Prepare in a format suitable for publication:

(a) Statement of comprehensive income for the year ended 30 June 2015. (12 marks)

(b) Statement of financial position as at 30 June 2015. (8 marks)
(Total: 20 marks)

QUESTION THREE
(a) Enumerate four enhancing qualitative characteristics of good financial information. (4 marks)

(b) Fulcon Ltd. deals in Italian shoes. It has a head office in Westlands, Nairobi and branches in several parts of the city. Accounts of all branches are maintained in the head office books. The following information relates to transactions carried out by the Eastlands branch for the year ended 31 December 2014. The amounts are stated at selling price.

	Sh. "000"
Opening inventory	31,680
Goods received from head office	700,368
Goods received from Southlands branch	3,360
Goods sent to Northlands branch from Eastlands branch	4,320
Goods returned to Eastlands branch by credit customers	5,280
Goods returned to Northlands branch by an Eastlands branch customer	1,932
Goods returned to head office	8,160
Goods stolen from Eastlands branch	5,760
Cash sales	316,800
Credit sales	370,116

Additional information:
1. Goods were marked at a normal markup of $^{3}/_{5}$.
2. To clear some old stocks, goods with a normal selling price of Sh.3 million were marked down by 20%. Two thirds of these goods had been sold as at 31 December 2014.
3. Other than the goods stolen there were no shortages or surpluses of goods in the year.

Required:
(i) Eastlands branch inventory account for year ended 31 December 2014. (6 marks)

(ii) Eastlands branch markup account for year ended 31 December 2014. (6 marks)

(iii) Goods sent to Eastlands branch account for the year ended 31 December 2014. (4 marks)
(Total: 20 marks)

QUESTION FOUR
(a) Bien Ltd. has provided the following schedule of its long-term loans for the year ended 31 March 2015:

	1 April 2014 Sh."million"	**31 March 2015 Sh."million"**
10% bank loan 2021	120	120
24% bank loan 2030	80	80
8% debentures	0	60

Additional information:
1. The 8% debenture was used to finance production of a mining equipment which commenced on 1 October 2014.
2. On 1 April 2014, the company had commenced construction of a power plant using existing borrowings. Expenditure for the construction was drawn with Sh.40 million being drawn on 1 April 2014 and Sh.30 million on 1 November 2014.

Required:
In line with provisions of IAS 23 (borrowing costs):

(i) Compute the borrowing costs to be capitalised. (4 marks)

(ii) Determine the cost of the assets constructed in the year. (4 marks)

(b) Madwang Ltd. leased out its plant to Kasheshe Hauliers Ltd. under a finance lease on 1 January 2010. The fair value of the plant on 1 January 2010 was Sh.870,000. The lease provided for 6 annual rentals of Sh.200,000 each receivable at the end of each year.

The interest rate implicit in the lease is 10%.

Required:
Using the actuarial method, show in the books of Madwang Ltd:

(i) Income statement extracts over the lease term. (6 marks)

(ii) Statement of financial position extracts suitably classified. (6 marks)
(Total: 20 marks)

QUESTION FIVE

(a) Explain the fair value model of accounting for investment property as per IAS 40 (Investment Property). (4 marks)

(b) The following information was extracted from the books of the Ministry of Tourism for the fiscal year ended 30 June 2015:

	Sh."000"
Accumulated fund	562,500
Cash and cash equivalents	375,000
Receivables	150,000
Inventory of consumables	75,000
Transfers from exchequer	1,875,000
Fees fines and licences	375,000
Liability for long term benefits	150,000
Long term borrowing	750,000
Finance costs	75,000
Supplies and consumables used	300,000
Wages and salaries	750,000
Other expenses	900,000
Transfers from other ministries	37,500
Transfers to other ministries	375,000
Computer equipment	200,000
Vehicles	175,000
Land and buildings	2,625,000
Revenue from exchange transactions	75,000
Other revenue	450,000
Payables	375,000
Reserves	1,350,000

Required:
(i) Statement of financial performance for the year ended 30 June 2015. (8 marks)

(ii) Statement of financial position as at 30 June 2015. (8 marks)
(Total: 20 marks)

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