

CERTIFIED PUBLIC ACCOUNTANT INTERMEDIATE LEVEL EXAMINATIONS

11.2: FINANCIAL REPORTING

TUESDAY: 9 JUNE 2015

INSTRUCTIONS:

1. **Time Allowed: 3 hours 15 minutes** (15 minutes reading and 3 hours writing).
2. This examination has **two** sections; **A & B**.
3. Section **A** has **three** compulsory questions.
4. Section **B** has **two** questions, **one** question to be attempted.
5. In summary attempt **four** questions, three in section A and one in section B.
6. Marks allocated to each question are shown at the end of the question.
7. Show all your workings.

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SECTION A

This section has three compulsory questions

QUESTION ONE

IAS 16 Property, Plant and Equipment and **IAS 40** Investment Property outlines the accounting treatment of tangible non-current asset. Kiyovu Ltd is a Gikondo based computer manufacturer and during the year ended 31 October 2013 the following transactions in relation to Property, Plant and Equipment took place.

1. On 1 April 2014, a new machine was purchased by Kiyovu Ltd. in order to improve productivity. The cost of the machine was Frw 60,000,000 but the company also incurred the following:

Description	Frw
Delivery costs	400,000
Labour installation costs (Note i)	1,500,000
Management and supervision (Allocated from head Office)	1,000,000
Material cost used for the installation-inclusive of 223 recoverable VAT	150,000
Cost of testing new machine (note ii)	300,000
Maintenance service contract cost per annum	40,000
Proceeds from sales of by-products produced as a result of the testing process	(10,000)

Notes:

- i) These were 20% higher than budgeted due to an individual dispute at the time of installation
- ii) Included in the testing costs of the machine was Frw 15,000 in connection with a quarterly diagnostic check of the machine.

Plant and machinery are depreciated at 25% straight line. The cost of plant and equipment at 1 November 2013 amounted to Frw 30,000,000 and the accumulated depreciation was Frw 18,000,000 at that date.

2. Kiyovu Ltd's head office building was originally acquired on 1 November 2013 for Frw 200,000,000 and is depreciated at 4% per annum straight line. On 1 November 2013, it was revalued at Frw 250,000,000. Due to the recent downturn in commercial property prices; property valuers acting for the company have advised that the valuation on 31 October 2014 should be Frw 200,000,000.

3. On 1 November 2013, Kiyovu Ltd purchased a property in Gitega costing Frw 50,000,000, for its investment portfolio. The amount attributable to land was negligible, and the buildings are expected to have a useful life of 40 years.

Local property indices indicate that property prices in this area have gone against the downward national trend, and that the fair value of the property has increased during the year to 31 October 2014.

REQUIRED:

- a) In relation to machinery and head office building, draft the non-current assets schedule showing the movements on property, plant and equipment for the year to October 2014. (12 Marks)
- b) Define the term investment property and explain why it may not be appropriate to charge depreciation in relation to such property. (4 Marks)
- c) Assuming that Kiyovu Ltd. adopts a fair value policy for the property in Gitega, explain how the property would be presented in the financial statements for the year to 31 October 2014, if the property has risen in value by 5% during the year. (Disclosure notes are not required). (4 Marks)

(Total 20 Marks)

QUESTION TWO

The statements of financial position for AB and XY as at 31 December 2014 are provided below:

	AB	XY
Assets	Frw “000”	Frw “000”
Non-Current assets		
Property, Plant and Equipment	9,715	3,800
Investment in XY	3,300	-
Current Assets		
Inventories	980	400
Receivables	900	600
Cash and cash equivalents	320	200
	<u>2,200</u>	<u>1,200</u>
Total assets	<u>15,017</u>	<u>5,000</u>
Equity and Liabilities		
Equity		
Share capital (Frw.100 per equity share)	3,200	1,000
Share premium	1,800	-
Retained earnings	4,800	3,600
Total equity	<u>9,800</u>	<u>4,600</u>
Non-current Liabilities		
Long-term borrowings	3,200	-
Deferred consideration	917	-
Current Liabilities		
Total Liabilities	5,217	400
Total Equity and Liabilities	<u>15,017</u>	<u>5,000</u>

Additional information:

- AB acquired 80% investment in XY on 1 January 2014. The consideration consisted of the following: the transfer of 500,000 shares in AB with a nominal value of Frw.100 each and a market value on the date of acquisition of Frw. 305 each; Frw.408,000 of cash paid on 1 January 2014; and Frw.1, 000,000 of cash, payable on 1 January 2015 (a discount rate of 9% has been used to value the liability in the financial statements of AB). At the date of acquisition XY had retained earnings of Frw. 2,300, 000. The investment in XY was classified as available for sale in the books of AB and is held at fair value. The gains earned to date are included in the retained earnings of AB.

It is the group policy to value non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interest at 1 January 2014 was Frw.750, 000.

- As at 1 January 2014 the fair value of net assets acquired was the same as the book value with exceptions of:
 - The fair value of property, plant and equipment was Frw. 300,000 higher than book value. These assets were to have remaining useful life of 6 years from the date of acquisition .A full year’s depreciation is charged in the year of acquisition and none in the year of sale.
 - The fair value of inventories was estimated to be Frw.100,000 higher than the book value. All of the inventories were sold by 31 December 2014.
 - Contingent liability which had a fair value of Frw.150,000 at the date of acquisition, had fair value of Frw. 70,000 at 31 December 2014.

3. XY sold goods to AB during the year for Frw. 300,000, Part of those goods with a sales value of Frw. 40,000 remaining in AB's inventories at 31 December 2014. XY makes 20% margin on sales.
4. AB issued a long term instrument on 1 January raising Frw. 3,400,000. The transaction costs associated with the issues was Frw.200,000 and have been correctly recorded.
The debt instrument has nominal rate of interest payable of 6% and interest due for 2014 was paid and recorded on 31 December 2014, however no further accounting entries have been made in respect of liability. The effective interest rate is approximately 7.05%.
5. No dividends were paid by either entity in year ended 31 December 2014.

REQUIRED:

- a) Consolidated statement of financial position for AB group as at 31 December 2014 **(18 Marks)**
- b) On 1 January 2014 AB issued 400,000 5% redeemable preference shares at their nominal value of Frw 1000 each. The shares have been recorded within equity and the preference dividend is payable on 31 December 2014.

REQUIRED:

- (i) Explain how the issue of the preference shares should be recorded, with specific reference to the relevant provisions of IAS 32 Financial Instruments: Presentation. **(6 Marks)**
- (ii) Prepare the journal entry required to correct the initial recording of the share issue and the journal entry that will be processed to record the dividend paid. **(6 Marks)**

(Total 30 Marks)

QUESTION THREE

Mulindi Ltd. has a number of subsidiaries, one of which is Remera Ltd, which was acquired during the year ended 31 December 2014. The draft consolidated financial statements for the year ended 31 December 2014 are as follows:

Consolidated statement of profit or loss for the year ended 31 December 2014

	Frw “000”
Profit from operation	1,120
Interest	(100)
	1,100
Share of profits of associates	240
Profit before tax	1,350
Taxation	(482)
	868
Non-controlling interest	(104)
Group profit	<u>764</u>

Statement of financial position is as follows:

	Mulindi Ltd Consolidated		Remera Ltd at acquisition
	31/12/2014	31/12/2013	
Assets	Frw 000	Frw 000	Frw 000
Non-current assets			
Property Plant and Equipment	4,730	2,610	610
Intangibles	350	310	-
Investment in associates	520	500	-
Investment in associates			
Current assets			
Inventories	740	610	150
Trade and other receivables	390	350	85
Cash and cash equivalent	40	85	20
Total assets	<u>6,770</u>	<u>4,465</u>	<u>865</u>
Equity and liabilities			
Frw 100 ordinary shares	1,400	1,000	500
Share premium	300	200	100
Retained earnings	1,615	865	80
Non-controlling Interest	580	610	-
Non-current Liabilities			
Long term loans	1,900	1,100	-
Current liabilities			
Trade payables	520	480	75
Taxation	455	210	110
Total Equity and Liability	<u>6,770</u>	<u>4,465</u>	<u>865</u>

Additional information:

1. Mulindi Ltd issued 4,000 Frw 100 ordinary shares at a premium of Frw 25 and paid cash consideration of Frw 197,500 to acquire 75% of Remera Ltd. At the date of acquisition, Remera Ltd's assets and liabilities were recorded at their fair value with the exception of some plant which had a fair value of Frw 90,000 in excess of its carrying value. Goodwill on acquisition was Frw 120,000.
2. The property, plant and equipment during the year to 31 December 2014 show plant with a carrying value of Frw 800,000 which was sold for Frw 680,000. Total depreciation for the year was Frw 782,000.

REQUIRED:

- a) Consolidated statement of cash flows in accordance with IAS 7 for the year ended 31 December 2014. (22 Marks)
- b) The managing Director of Mulindi Ltd has asked you to draft a memorandum, briefly explaining the following :
 - (i) Why it is important to remove unrealized profits arising from transactions between companies in a group? (3 Marks)

- (ii) Whether it is possible for a business to be making losses year after year but still increase its bank balance? **(3 Marks)**
- (iii) The difference between the direct method and indirect methods of calculating the net cash flow from operating activities. **(Total 30 Marks)**

SECTION B

Attempt one of the two questions in this section.

QUESTION FOUR

(a) Impapuro Products Ltd. is a large paper manufacturing company. The company's Finance Director is working on the published accounts for the year ended 31st March 2015. The Chief Accountant has prepared the following list of problems which will have to be resolved before the statements can be finalized.

1. Events after the reporting date

A fire broke out at the company's factory on 4 April, 2015. This has destroyed the administration block. Most of the costs incurred as a result of this fire were uninsured. A major customer went into liquidation on 27 April, 2015. The customer's balance at 31st March 2015 remains unpaid. The receiver has intimated that unsecured payables will receive very little compensation, if any. **(5 Marks)**

2. Possible Investment Property

The company decided to take advantage of the down turn in property prices and purchased a new office building at Ruhengeri. This was purchased with the intention of the building being resold at a profit within five years. In the meantime, the company is using the property to house the administrative staff until such time as their own offices can be repaired. It is anticipated that this will take at least nine months. The Managing Director has suggested that the building should not be depreciated. **(3 Marks)**

3. Possible Development Expenditure

The company paid the Engineering Department at Kigali University a large sum of money to design a new pulping process which will enable the use of cheaper raw materials. This process has been successfully tested in the University's laboratories and is almost certain to be introduced at Impapuro Products Ltd. pulp-plant within the next few months.

The company paid a substantial amount to the University's Biology Department to develop a new tree species of tree which could grow more quickly and therefore enable the company's forest to produce more wood for paper manufacturing. The project was successful in that a new tree was developed. Unfortunately, it was prone to disease and the cost of the chemical sprays needed to keep the wood healthy rendered the tree uneconomical. **(6 Marks)**

4. Possible Contingent Liabilities

One of the company's employees was injured during the year. He had been operating a piece of machinery which had been known to have a faulty guard. The company's lawyers have advised that the employee has a very strong case, but will be unable to estimate the likely financial damages until further medical evidence becomes available.

One of the company's customers is claiming compensation for the losses sustained as a result of a delayed delivery. The customer had ordered a batch of cut sheet with the intention of producing leaflets to promote a special offer. There was a delay in supplying the paper and the leaflets could not be prepared in time. The company's lawyers have advised that there was no specific agreement to supply the goods in time for this promotion and furthermore, that it would be almost impossible to attribute the failure of the special offer to the delay in the supply of the paper. **(6 Marks)**

REQUIRED:

Explain how each of these matters should be dealt with in the published accounts for the year ended 31 March, 2015 in the light of the International Financial Reporting Standards. You should assume that the amounts involved are material in each case. **(Total 20 Marks)**

QUESTION FIVE

a) Conceptual framework of accounting is a coherent system of interrelated objectives and fundamental principles which prescribes the nature, function and limits of financial accounting and financial statements.

REQUIRED:

- i) Outline five (5) objectives the IASB's conceptual framework of accounting seeks to achieve. **(5 Marks)**
- ii) State the main contents of the IASB's conceptual framework for financial reporting. **(5 Marks)**

(b) You are the Financial Accountant of Makena Ltd. The Assistant Accountant responsible for preparing the 2014 annual financial statements is considering the accounting treatment of the following non-current assets and has approached you for guidance.

i) Makena Ltd acquired a property on 1 January 2009 at a cost of Frw 400 Million and immediately occupied it as office premise. On acquisition, it was estimated to have a useful life of 50 years. Subsequent to its acquisition, the asset was measured at depreciated cost until 1 July 2014 when management of Makena Ltd decided to convert the building into an investment property (mainly for rentals). Following this decision, the property was fair valued at Frw 373.8 Million. Makena Ltd adopted the fair value model for subsequent measurement of the investment property. At 31 December 2014, it was fair valued at Frw 380 Million

REQUIRED:

- Account for the treatment of this property in the 2014 financial statements of Makena Ltd. **(5 Marks)**
- ii) Makena Ltd had the following loans in place at the beginning and end of 2014

	1 January 2014	31 December 2014
	Frw	Frw
12.5% Debenture stocks (repayable in 2017)	480 Million	480 Million
15% Bank loan (repayable in 2016)	320 Million	320 Million

On 1 January 2014 the company began the construction of a qualifying asset, a piece of machine for hydro

electric plant at a cost of Frw 400 Million , using existing borrowings (the 12.5% debenture and the 15% bank loan). Expenditure incurred on for the construction was Frw 120 Million on 1 January 2014; Frw 80 Million on 1 May 2014 and Frw 200 Million on 1 October 2014. The machine was completed and put to use on 31December 2014.

REQUIRED:

Calculate the borrowing costs to be capitalized for the machine. **(5 Marks)**

(Total 20 Marks)

End of question paper