

CERTIFIED PUBLIC ACCOUNTANT INTERMEDIATE LEVEL EXAMINATION

11.2: FINANCIAL REPORTING

MONDAY: 6 JUNE 2016

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.

SECTION A

This section has three compulsory questions

QUESTION ONE

Munini Ltd is a merchandising business located in Kigali and has recorded a steady expansion in the last three years. In 2014 it opened a branch in Musanze after procuring the premises and other physical resources needed for the branch to become operational. In order to meet customer demand of the branch without constraining the cash flows of the head office in Kigali, it was appointed as a commission agent for Uruganda Distributors Ltd (Uruganda), a company located in Mombasa.

This principal-agent relationship has made it possible for Uruganda to tap into the Rwandan market and remain a consignor for Munini since 2014. The consignment agreement provides that Uruganda shall bear all expenses of Munini which relate to all consignments and an agency commission of 10% of all consignment sales shall be paid to Munini.

- (a) The following transactions transpired between Uruganda and Munini during the year ended March 31, 2016:
- (i) On 1 April, 2015 Uruganda sent a consignment of 1,000 boxes of merchandise to Munini at a cost of Frw 200,000 per box. Carriage, freight and insurance costs of the consignment paid by Munini during the year amounted to Frw 20 million.
 - (ii) On 1 March, 2016 Uruganda received Frw 150 million from Munini.
 - (iii) Munini incurred the following expenses during the year ended 31 March, 2016:
 - Delivery charges to customers Frw 259,000.
 - Advertising charges Frw 500,000.
 - Warehouse rent Frw 21.6 million.
 - (iv) At the end of March, 2016 Munini had sold the whole consignment at Frw 300,000 per box.

Required:

Prepare the Uruganda consignment account in the books of Munini for the year ended 31 March, 2016. **(5 Marks)**

- (b) Munini maintains the books of account of its branch in Musanze along with those of its own operations. The goods sent to Musanze account maintained by Munini is used to identify head office purchases separately. Munini transfers goods to Musanze at cost price.

The following information in the books of Munini Ltd relate to Musanze branch.

Opening balance 1 April, 2015	Frw '000'
Branch inventory (at cost to Munini)	189,000
Branch debtors	81,300
Branch bank	54,600
Closing balances 31 March, 2016	
Branch inventory (at cost to Munini)	144,000
Transactions during the year ended 31 March 2016:	
Goods transferred to Musanze branch at cost	387,000
Goods returned from Musanze branch at cost	7,200
Cash transferred from Musanze branch bank	521,700
Cash sales paid into bank	75,600
Credit sales	487,200
Returns inwards to Musanze branch by credit customers at selling price	1,800
Cheques received from credit customers	510,300
Discounts allowed to credit customers	4,500
Bad debts written off	900
Annual rent paid for warehouse and offices at Musanze branch	6,600
Wages	2,400
Insurance expenses (warehouse)	2,100

Required:

Prepare the following accounts in the books of Munini with regard to Musanze branch for the year ended 31 March, 2016:

- (i) Musanze branch trading account **(3 Marks)**
- (ii) Musanze branch debtors account **(3 Marks)**
- (iii) Musanze branch bank and cash account **(4 Marks)**

- (c) Munini Ltd has embarked on a programme to counter its ever rising rental costs by contracting a civil engineering company to construct warehouses in Kigali and Musanze branch. The construction is estimated to take three years. The civil engineering company has submitted a draft construction contract. The management of Munini Ltd has contacted you to explain the contents of the draft construction contract before it is signed.

Required:

Explain to the management of Munini the following as applied under IAS 11 Construction Contracts:

- (i) Contract revenue **(1 Mark)**
 - (ii) Contract costs **(1 Mark)**
 - (iii) Fixed price contract **(1 Mark)**
 - (iv) Determination of the stage of completion of a contract **(1 Mark)**
 - (v) Costs relating directly to a contract **(1 Mark)**
- (Total 20 Marks)**

QUESTION TWO

- (a) Icumbi Ltd was incorporated in Rwanda in the construction sector. Icumbi Ltd earns most of its income from the construction of roads and houses. In a bid to fulfill the demand of the rapid growth in the housing sector, Icumbi Ltd on 1 February, 2014 bought machinery under a finance lease. The cash price of the machinery was Frw 20,000,000. The expected useful life of the machinery was 6 years. The lease agreement requires Icumbi Ltd to pay annual lease rentals of Frw 5,966,311 for five years starting 1 January, 2015.

Required:

- (i) Briefly explain any two conditions that must be satisfied for a lease to be classified as a finance lease under IAS 17: Leases. **(5 Marks)**
 - (ii) Explain how Icumbi Ltd should record the lease of machinery in its financial statements and prepare the financial statements extracts for periods ending 31 January, 2015 and 2016. The interest rate implicit in the lease is 15%. **(8 Marks)**
- (b) Amashi (R) Ltd deals in construction materials and equipment. The following information has been extracted from the financial statements of Amashi (R) Ltd.

	2015		2014	
	Frw '000'	Frw '000'	Frw '000'	Frw '000'
Non-current assets:				
Property, plant and equipment		425,200		286,000
Current assets:				
Inventory	124,000		106,700	
Trade receivables	142,340		120,200	
Cash and bank	60,200	326,540	52,000	278,900
Current liabilities:				
Trade payables	87,240		93,520	
Taxation	15,230	(102,470)	14,300	(107,820)
		<u>649,270</u>		<u>457,080</u>
Financed by:				
Share capital		220,000		200,000
Share premium		56,000		50,000
Retained profits		216,030		104,580
Long-term loan		<u>157,240</u>		<u>102,500</u>
		<u>649,270</u>		<u>457,080</u>

Additional information:

- (i) Amashi (R) Ltd's property, plant and equipment schedule for the period ended 31 May, 2015 was as follows:

	Buildings	Machinery	Furniture & fittings	Total
	Frw '000'	Frw '000'	Frw '000'	Frw '000'
Cost:				
At 31 May, 2014	200,000	80,000	50,000	330,000
Additions	150,000	25,000	5,000	180,000
Disposals		(12,000)		(12,000)
At 31 May, 2015	<u>350,000</u>	<u>93,000</u>	<u>55,000</u>	<u>498,000</u>
Depreciation:				
At 31 May, 2014	20,000	16,000	8,000	44,000
Charge for the year	17,500	9,300	4,400	31,200
Disposals		(2,400)		(2,400)
At 31 May, 2015	<u>37,500</u>	<u>22,900</u>	<u>12,400</u>	<u>72,800</u>
Net book value:				
At 31 May 2014	180,000	64,000	42,000	286,000
At 31 May 2015	<u>312,500</u>	<u>70,100</u>	<u>42,600</u>	<u>425,200</u>

- (ii) The depreciation rates applicable by Amashi (R) Ltd are buildings 5%, machinery 10% and furniture & fittings 8%. It is company policy to charge full depreciation in the year of acquisition and none in the year of disposal.
- (iii) During the year ended 31 May, 2015, Amashi (R) Ltd disposed of an item of machinery. The profit on disposal was Frw 3,000,000, and has been incorporated in the profit for the year.
- (iv) The corporation tax rate is 30%. Assume that the long-term loan was acquired interest free.
- (v) During the year ended 31 May, 2015 Amashi (R) Ltd issued 20,000 Frw 1,000 additional shares at a premium of Frw 300.

Required:

In accordance with the requirements of IAS 7; Statement of Cash Flows:

- (i) Prepare a statement of cash flows for the period ended 31 May, 2015 for Amashi (R) Ltd using the indirect method. **(10 Marks)**
- (ii) State the advantages the direct method of preparing statements of cash flows has over the indirect method. **(2 Marks)**
- (c) IAS 37; Provisions, Contingent Liabilities and Contingent Assets, specifies the conditions under which an entity shall recognise a provision, contingent asset and contingent liability.

Required:

- (i) Explain what is meant by an 'onerous contract' and a 'constructive obligation'. **(2 Marks)**
- (ii) Explain the conditions under which a provision should be recognised as a liability in the financial statements. **(3 Marks)**

(Total 30 Marks)

QUESTION THREE

- (a) Gikondo Ltd deals in the processing of agricultural products into finished products that can be stored for a long time. In a bid to expand its distribution network, Gikondo Ltd made an offer of Frw 100,000,000 for the whole of the share capital of Inyanza Ltd a company that sells processed agricultural products. The offer was accepted and payment made in cash.

The statements of financial position for the two companies immediately before the takeover on 30 September, 2015 were as follows:

	Gikondo Ltd	Inyanza Ltd
	Frw '000'	Frw '000'
Non-current assets	450,000	70,000
Current assets	<u>350,000</u>	<u>20,000</u>
	800,000	90,000
Current liabilities	<u>(140,000)</u>	<u>(15,000)</u>
Total assets	<u>660,000</u>	<u>75,000</u>
Financed by:		
Share capital Frw 1,000 per share	400,000	60,000
Revenue reserves	<u>260,000</u>	<u>15,000</u>
	<u>660,000</u>	<u>75,000</u>

The fair value placed on the tangible non-current assets of Inyanza Ltd for purposes of the takeover was Frw 75,000,000.

Required:

In accordance with the requirements of IFRS 3 Business Combinations:

- (i) Prepare Gikondo Ltd's statement of financial position as at 30 September, 2015 before and after the takeover. **(9 Marks)**
- (ii) Briefly explain the circumstances under which negative goodwill may arise and how it should be recognised in the financial statements. **(6 Marks)**
- (b) Kabeza Ltd deals in the distribution of a variety of products. It also has investments in other companies. The management of Kabeza Ltd, while reviewing the financial statements of the company for the year ended 30 June, 2015 realised that some transactions had occurred between 1 July, 2015 and 31 December, 2015. Some of these transactions had been adjusted in the financial statements while others had not. The financial statements were authorized for issue on 31 December, 2015. The following are some of the transactions that had occurred:
- (i) On 1 September, 2015 the board of directors of Kabeza Ltd declared a dividend of Frw 500 per share.
- (ii) Kabeza Ltd owns investments in other companies; the fair value of these investments on 10 October, 2015 had declined by Frw 10,500,000.
- (iii) On 1 July, 2015 Haba Ltd, one of the clients of Kabeza Ltd who had multiple loans obtained from different financial institutions, was declared bankrupt by court as all its assets had been attached by the different financial institutions to recover the loans. Haba Ltd had purchased goods on credit from Kabeza Ltd on 15 June, 2015 to a tune of Frw 8,500,000.

- (iv) On 18 August, 2015 one of the warehouses of Kabeza Ltd caught fire as a result of an electric short circuit. A report prepared by registered valuers shows that the value of the damaged inventory was Frw 50,000,000.
- (v) On 30 September, 2015, the board of directors announced plans to take over two other companies: Zig Ltd and Zura Ltd that are operating in the same industry to leverage Kabeza Ltd and enable it to compete internationally. This takeover was estimated to cost Frw 200,000,000.
- (vi) Kabeza Ltd settled a case that was before court on 1 October, 2015. This case had earlier been filed by members of the community for the damage inflicted on the community by Kabeza Ltd. The cost of settlement was Frw 60,000,000, and management had earlier provided for it.

Required:

As the finance manager, write a memo to the board of directors of Kabeza Ltd explaining to them what is meant by ‘adjusting’ and ‘non-adjusting’ events as specified in IAS 10 Events after the Reporting Period and how the above transactions should be treated in the financial statements. **(15 Marks)**

(Total 30 Marks)

SECTION B

Attempt one of the two questions in this section

QUESTION FOUR

- (a) The objective of IAS 40: Investment Property is to prescribe the accounting treatment for investment property and related disclosure requirements.

Required:

Explain what is meant by ‘investment property’ and state the circumstances under which an asset may cease being classified as an investment property. **(5 Marks)**

- (b) IFRS 5: Non-current Assets Held for Sale and Discontinued Operations requires that assets or groups of assets that are held for sale, be presented separately on the face of the statement of financial position and the results of discontinued operations to be presented separately in the statement of profit or loss.

Required:

- (i) Explain the conditions that must be met for an asset to be classified as held for sale and discontinued operations, as per the requirements of IFRS 5. **(3 Marks)**
- (ii) State any four additional disclosures that are required to be made once a non-current asset has either been classified as held for sale or sold. **(4 Marks)**
- (c) Explain the following concepts as applied under IAS 12: Income Taxes, giving an example of each where applicable.
 - (i) Deductible temporary differences. **(2 Marks)**
 - (ii) Tax base of an asset. **(2 Marks)**
 - (iii) Taxable temporary differences. **(2 Marks)**
 - (iv) Deferred tax assets. **(2 Marks)**

(Total 20 Marks)

QUESTION FIVE

- (a) Abdai Rwanda has its head office in the United States of America where the local currency is the United States Dollar (USD). The following trial balance was prepared by Abdai Rwanda for incorporation into Abdai Global's financial statements for the year ended 31 March, 2016.

	Frw '000'	Frw '000'
Non-current assets at cost	47,400	
Accumulate depreciation		12,270
Inventory 1 April, 2015 at cost	21,840	
Trade receivables and payables	11,400	5,400
Goods from head office	80,700	
Sales		116,100
Operating expenses	19,980	
Bank	4,500	
Head office current account		52,050
	<u>185,820</u>	<u>185,820</u>

Additional information:

- (i) Inventory at 31 March, 2016 was Frw 25.5 million.
(ii) Assume the following exchange rates of 1 USD to Frw:

1 April, 2015	Frw 608
31 March, 2016	Frw 760
Average rate for year	Frw 684

The affairs of Abdai Rwanda are very closely interlinked with those of the head office in United States of America.

Assume the opening and closing inventory was translated at the following opening and closing rates:

- (iii) Non-current assets were acquired as follows

	Non-current Assets	Accumulated Depreciation	Rate
	Frw "000"	Frw "000"	Frw
1 April, 2015	14,400	720	608
Prior to 1 April, 2015	<u>33,000</u>	<u>11,550</u>	380
31 March, 2016	<u>47,400</u>	<u>12,270</u>	

- (iv) At 31 March, 2016, the following items were in transit:

From head office to Abdai Rwanda USD 7,850.

From Abdai Rwanda to the United States of America Frw 900,000.

- (v) In the head office ledger the following balances appeared at 31 March, 2016:

	USD
Goods to Abdai Rwanda	122,368
Abdai Rwanda current account	103,224

Required:

- (i) Translate the Abadai Rwanda trial balance into USD. (7 Marks)
 - (ii) Prepare, in USD, the trading and profit or loss account for Abdai Rwanda for the year ended March 31, 2016 and statement of financial position as at that date. (8 Marks)
 - (iii) Compute the head office current account in USD and round off to the nearest whole dollar.
- (b) During 2016 Abdai Rwanda discovered the following:
- (i) The board of directors had recommended a change from inventory valuation using weighted average cost to first in first out (FIFO) for a more appropriate presentation of transactions. However, it was found that it was impracticable to determine the cumulative amount of the change.
 - (ii) The non-current assets were reviewed during 2016 and discovered that they actually had a useful economic life of 25 years. These assets were being depreciated on straight line basis using an estimated useful economic life of 20 years. It is proposed that the effect of this change to the year ended 31 March, 2016 and future periods be included in the determination of net profit.
 - (iii) During the reconciliation of head office and Abdai Rwanda in 2016, it was discovered that goods sent from the head office had been overstated by USD 3,464 in the Abdai Rwanda books. These are included in the goods from head office on the trial balance for the year ended 31 March, 2016. However, their effects are not included in the translation.

Required:

Explain how the changes in accounting policy, accounting estimate and errors given above will be treated in the financial statements. (5 Marks)

(Total 20 Marks)

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