

# **ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS**

# LICENTIATE LEVEL L 1: Financial Reporting June 2010 December 2010 June 2011

**QUESTION PAPERS AND SUGGESTED SOLUTIONS** 

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# ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS CHARTERED ACCOUNTANTS EXAMINATIONS

# LICENTIATE LEVEL

L1: FINANCIAL REPORTING

**SERIES: JUNE 2010** 

TOTAL MARKS - 100 TIME ALLOWED: THREE (3) HOURS

#### **INSTRUCTIONS TO CANDIDATES**

- 1. You have ten (10) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
- 2. This paper is divided into TWO sections:
  - Section A: Attempt this ONE question.
  - Section B: Attempt THREE questions only.
- 3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
- 4. Do NOT write in pencil (except for graphs and diagrams).
- 5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
- 6. All workings must be done in the answer booklet.
- 7. Present legible and tidy work.
- 8. Graph paper (if required) is provided at the end of the answer booklet.

## **SECTION A**

(This question is compulsory and must be attempted)

# Question 1

Muko Plc, listed on its local stock exchange, is a retail organization operating several retail outlets countrywide. A reorganization of the company was started in 2008 because of significant reduction in profits. This reorganization was completed during the current financial year.

The trial balance for Muko Plc at 30 September 2009 was as follows:

	K'000	K'000
10% debentures 2020		1,000
Administrative expenses	615	
Bank and cash	159	
Buildings at 30 September 2008	11,200	
Cash received on disposal of equipment		11
Cost of sales	3,591	
Debenture interest paid – half year to 31 March 2009	50	
Trade receivables	852	
Distribution costs	314	
Furniture and fixtures at 30 September 2008	2,625	
Investment properties at market value 30 September 2008	492	
Dividends paid	1,600	
Rental income received		37
Ordinary shares of K1 each, fully paid at 30 September 2009		4,000
Retained earnings at 30 September 2008		1,390
Deferred tax liability		256
Provision for reorganization expenses at 30 September 2008		1,010
Accumulated depreciation at 30 September 2008:		
Buildings		1,404
Furniture and fixtures		1,741
Reorganization expenses	900	
Revaluation surplus		172
Sales		9,415
Share premium		2,388
Inventories at 30 September 2009	822	
Trade payables		396
	23,220	23,220

#### ADDITIONAL INFORMATION PROVIDED:

- (i) The reorganization expenses relate to a comprehensive restructuring and reorganization of the company that began in 2008. Muko Plc's financial statements for 2008 include a provision for reorganization expenses of K1,010,000. All costs had been incurred by the year end, but an invoice for K65,000, received on 2 October 2009, remained unpaid and is not included in the trial balance figures. No further restructuring and reorganization costs are expected to occur and the provision is no longer required. The decrease/increase should be taken to profit or loss.
- (ii) Investment properties are carried in the financial statements under the fair value of IAS 40. The market value of the properties at 30 September 2009 was K522,000. There were no additions or disposals of investment properties held during the year. The decrease/increase should be taken to profit or loss.
- (iii) On 1 November 2009, Muko Plc was informed that one of its credit customers, Dalitso, had ceased trading. The liquidators advised Muko Plc that it was very unlikely to receive payment of any of the K45,000 due from Dalitso at 30 September 2009.
- (iv) One of Muko Plc's customers is suing the company for damages as a consequence of a faulty product. Legal advisers are currently advising that the probability of Muko Plc being found liable is 75%. The amount payable is estimated to be the full amount claimed of K100.000.
- (v) The income tax charge for the year ended 30 September 2009 is estimated at K1,180,000 and the deferred tax liability needs to be adjusted to K281,000 (all movement to profit or loss).
- (vi) The directors paid dividends amounting to 40 nawee per share during the period.
- (vii) During the year, Muko Plc disposed of old equipment for K11,000. The original cost of this equipment was K210,000 and accumulated depreciation at 30 September 2008 was K205,000 Muko Plc's accounting policy is to charge no depreciation in the year of disposal. There were no additions to property, plant and equipment in the year.
- (viii) Depreciation is charged to cost of sales using the straight-line basis on property, plant and equipment as follows:

Buildings 3% Furniture and fixtures 20%

- (ix) On 1 April 2009, Muko Plc made a rights issue of 1 new share for 4 existing shares, at a price of K3. The rights issue had been fully accounted for by 30 September 2009.
- (x) On 30 September 2009, the buildings were revalued to K9,500,000.

#### Required

Prepare the income statement for Muko Plc for the year to 30 September 2009 and a statement of financial position (Balance sheet) at that date.

(Total 25 marks)

#### **SECTION B**

(Attempt any three questions in this section)

#### Question 2

On 1 August 2007 Puku purchased 18 million of a total of 24 million equity shares in Sable. The acquisition was through a share exchange of two shares in Puku for every three shares in Sable. Both companies have shares with a par value of K1 each. The market price of Puku's shares at 1 August 2007 was K5·75 per share. Puku also paid cash of K2·42 per acquired share of Sable. The reserves of Sable on 1 April 2007 were K69 million. Puku has held an investment of 30% of the equity shares in Antelope for many years.

The summarized income statements for the three companies for the year ended 31 March 2008 are:

	Puku K'000	Sable K'000	Antelope K'000
Revenue	150,000	78,000	80,000
Cost of sales	(94,000)	(51,000)	(60,000)
Gross profit	56,000	27,000	20,000
Distribution costs	(7,400)	(3,000)	(3,500)
Administrative expenses	(12,500)	(6,000	(6,500)
Finance costs (note (ii))	(2,000)	(900)	nil
Profit before tax	34,100	17,100	10,000
Income tax expense	(10,400)	(3,600)	(4,000)
Profit for the period	23,700	13,500	6,000

#### THE FOLLOWING INFORMATION IS RELEVANT:

(i) The fair values of the net assets of Sable at the date of acquisition were equal to their carrying amounts with the exception of property and plant. Property and plant had fair values of K4·1 million and K2·4 million respectively in excess of their carrying amounts. The increase in the fair value of the property would create additional depreciation of K200,000 in the consolidated financial statements in the post acquisition period to 31 March 2008 and the plant had a remaining life of four years (straight-line depreciation) at the date of acquisition of Sable. All depreciation is treated as part of cost of sales.

The fair values have not been reflected in Sable's financial statements. No fair value adjustments were required on the acquisition of Antelope.

- (ii) Prior to its acquisition, Sable had been a good customer of Puku. In the year to 31 March 2008, Puku sold goods to Sable at a selling price of K10 million. Puku made a profit of 20% on the cost of these sales. At 31 March 2008 Sable still held inventory of K3 million (at cost to Sable) of goods purchased in the post acquisition period from Puku.
- (iii) An impairment test on the goodwill of Sable conducted on 31 March 2008 concluded that it should be written down by K2 million. The value of the investment in Antelope was not impaired.
- (iv) All items in the above income statements are deemed to accrue evenly over the year.
- (v) Ignore deferred tax.

#### Required:

- (a) Calculate the goodwill arising on the acquisition of Sable at 1 August 2007. (6 marks)
- (b) Prepare the consolidated income statement for the Puku Group for the year ended 31 March 2008.

**Note:** assume that the investment in Antelope has been accounted for using the equity method since its acquisition. (15 marks)

(c) At 31 March 2008 the other equity shares (70%) in Antelope were owned by many separate investors. Shortly after this date Eland (a company unrelated to Puku) accumulated a 60% interest in Antelope by buying shares from the other shareholders. In May 2008 a meeting of the board of directors of Antelope was held at which Puku lost its seat on Antelope's board.

#### Required:

Explain, with reasons, the accounting treatment Puku should adopt for its investment in Antelope when it prepares its financial statements for the year ending 31 March 2009. (4 marks)

(Total 25 marks)

Question 3

The financial statements for Chimwemwe Plc for the year ended 31 March 2008 are as follows:

# Statement of Comprehensive Income for the year ended 31 March 2008

	K'000
Revenue	20,000
cos	(14,200)
Gross profit	5,800
Operating expenses	(2,048)
Profit from operations	3,752
Interest receivable	100
Interest payable	(640)
Profit before tax	3,212
Tax	(1,300)
Profit for the year	1,912
Other comprehensive income:	
Gain on land revaluation	2,000
Total comprehensive income	3,192

Statement of Changes in Equity for the year ended 31 March 2008

	Share capital K'000	Share premium K'000	Revaluation premium K'000	Retained earnings K'000	Total K'000
Balance at 1 April 2007	4,000	1,200	-	1,108	6,308
Profit for year				1,912	1912
Share issue	2,000	516			2,516
Dividend paid				(800)	(800)
Revaluation			2,000		2,000
Balance at 31 March 2008	6,000	1,716	2,000	2,220	11,936

# The following information may also be relevant:

(1) Non-current assets

	2008			2007
	Cost	Depreciation	Cost	Depreciation
	K'000	K'000	K'000	K'000
Intangibles	1,400	800	800	400
Property, plant and equipment	10,000	3,100	6,000	2,800

- (2) At 1 April 2007, freehold land was revalued from K2,000,000 to K4,000,000.
- (3) During the year, plant and machinery which had cost K1,200,000 and had a carrying amount of K200,000 was sold for K500,000.
- (4) Development costs of K600,000 were capitalised during the year as the recognition criteria per IAS 38 were met.
- (5) Part of the loan notes had reached their redemption period during the year and were repaid accordingly.
- (6) Ordinary shares were issued for cash during the year.
- (7) Current asset investments at 1 April 2007 were sold during the year for K188,000.

These had never been classed as a cash equivalent. The profit or loss on disposal was included in operating expenses.

# Required:

- (a) Prepare a statement of cash flow for Chimwemwe plc for the year ended 31 March 2008 which meets the requirements of IAS 7 Statement of Cash Flows, using the indirect method.

  (18 marks)
- (b) Comment on the changes in cash flow and financial position of Chimwemwe during the year using the information given in the question and the statement of cash flow calculated at part
   (a). (7 marks)

(Total 25 marks)

# Question 4

Mzilikazi and his son Lobengula have been in partnership for a number of years and share profits (and losses) in the ratio 2:1. However, on 1 June 2006 they decide to dissolve their partnership to pursue other interests. The statement of Financial position of the partnership at 31 May 2006 is given below:

# Mzilikazi and Lobengula Partnership

# STATEMENT OF FINANCIAL POSITION (BALANCE SHEET) AS AT 31 MAY 2006

·	K'000	K'000
Non-current assets at NBV		
Equipment		4,000
Motor vehicles		6,000
		10,000
Current assets		
Investments	10,000	
Receivables	14,000	
Bank	500	
		24,500
		34,500
Capital accounts		
Mzilikazi		10,000
Lobengula		7,000
		17,000
Current accounts		
Mzilikazi	4,000	
Lobengula	2,500	
		6,500
Payables		10,000
Loan from Zwide		1,000
		34,500

At dissolution, it was agreed by the partners that Lobengula could take some equipment, which had a net book value of K500,000 at a valuation of K750,000. It was also agreed that Mzilikazi will take over responsibility for the loan from Zwide. Other equipment was sold for K3, 300,000. All vehicles were sold for a total of K5,500,000. The receivables (debtors) only realised K11,300,000, and the payables were settled for K9,000,000. The partners' investments realised K13,400,000 and there were dissolution expenses of K800,000.

## Required

Show the relevant accounts and the final distribution between partners after the dissolution of the partnership.

(Total 25 marks)

# Question 5

As at 31 May 2008 the following trial balances were extracted at the head office and branch of Mweruwantipa Ltd.

## **HEAD OFFICE**

	Debit K'000	Credit K'000
Non current assets	Nil	
Retained earnings		25,800
Current accounts	60,500	
Stock at cost or mark-up at 1 June 2007	48,500	
Purchases/sales	255,000	229,700
Expenses	46,900	
Provision for unrealised profit		1,400
Goods sent to branch		154,000
	410,900	410,900
BRANCH		
	Debit	Credit
	K'000	K'000
Non current assets	74,200	
Retained earnings		Nil
Current accounts		51,500
Stock at cost or mark-up at 1 June 2007	15,400	
Purchases/sales	148,500	199,700
Expenses	13,100	
	251,200	251,200
NITIONAL INCODMATION:		

#### ADDITIONAL INFORMATION:

- (a) All goods sold by the branch are supplied from head office at cost plus 10%. At 31 May 2008 goods valued at K 5,500,000 were in transit to the branch.
- (b) The branch deposited K3,000,000 on behalf of the head office in the bank on 31 May 2008. No record of this transaction has been made in the head office books.
- (c) Inventory at 31 May 2008, excluding goods in transit, were as follows: Head office at cost K 54,500,000

  Branch at mark-up K 17, 600,000

(d) Head office has recharged the branch with K 500,000 of expenses. The invoice for these expenses had not yet reached the branch at 31 May 2008.

# Required:

Prepare the Income statement and Statement of financial position (Balance Sheet) as at 31 May 2008 for the Head office, branch, and the Combined entity of Mweruwantipa Ltd.

(Total 25 marks)

#### Question 6

IAS 38 Intangible Assets defines the difference between research expenditure and development expenditure. IAS 38 also lays down rules which must be applied to the capitalisation of research and development expenditure.

# Required:

- (a) Explain the meaning of the terms research expenditure and development expenditure. (3 marks)
- (b) Explain the criteria applied to research and development expenditure, according to IAS 38, to determine whether the cost should be capitalized. (8 marks)
- (c) Discuss briefly why there was a need for an accounting standard relating to research and development expenditure. (4 marks)
- (d) Sekeletu, a listed company, is a large paper-manufacturing enterprise. The company's finance director is working on the published accounts for the year ended 31 March 2009. The chief accountant has prepared the following list of problems which will have to be resolved before the statements can be finalised.
  - (i) The company paid the engineering department at Kololo 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 Sekeletu's pulping plant within the next few months.

    (5 marks)
  - (ii) The company paid a substantial amount to the University's biology department to develop a new species of tree which could grow more quickly and therefore enable the company's forests to generate more wood for paper manufacturing. The project met with some success 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 uneconomic. (5 marks)

# Required:

Explain how each of these matters should be dealt with in the published accounts for the year ended 31 March 2009 in the light of IAS 38 Intangible Assets. You should assume the amounts involved are material in every case.

(Total 25 Marks)

#### **END OF PAPER**

# JUNE 2010 L1: FINANCIAL REPORTING SUGGESTED SOLUTIONS

# Solution 1

(a)

	K'000	K'000
Revenue		9,415
Cost of sales (3,591 + 819)		(4,410)
Gross profit		5,005
Distribution costs		(314)
Administrative expenses (W1)		(760)
Finance costs (W3)		(100)
Restructuring provision reversed unused ((900 + 65) – 1,010)	45	
Fair value gain on investment properties (W5)	30	
Profit on disposal of equipment (W6)	6	
Rental income	37	118
Profit before tax		3,949
Income tax expense (1,180 + 25)		(1,205)
PROFIT FOR THE YEAR		2,744
MUKO PLC - STATEMENT OF FINANCIAL POS	ITION AS AT 30 SE	EPTEMBER 2009
	K'000	K'000
Non-current assets		
Property, plant and equipment (W2)	9,896	
Investment properties (W5)	522	
		10,418
Current assets		
Inventories	822	
Trade receivables (852 – 45)	807	
Cash	159	
Oudii		1 700
Odon		1,700
Oudii		
Equity		
	4,000	1,788 12,206

Retained earnings (1,390 + 2,744 – 1,600)	2,534	
Revaluation surplus (172 + (W2) 40)	212	
, , ,		9,134
Non-current liabilities		,
10% debentures 20Y0	1,000	
Deferred tax liability (W4)	281	
Provisions	100	
		1,381
Current liabilities		
Trade payables	396	
Income tax payable	1,180	
Interest payable (W3)	50	
Other payables	65	
		1,691
		12,206
Workings		
1 Administrative expenses		
	K'000	K'000
As per TB		615
Bad debt written off – Dalitso *	45	
Provision for legal claim re faulty product **	100	145
		760

<sup>\*</sup> Adjusting event – provides additional evidence of conditions existing at the end of the reporting period as per IAS 10.

# 2 Property, plant and equipment

	Buildings K'000	Plant & equip. K'000	Total K'000
Cost b/d	11,200	2,625	13,825
Accumulated dep'n b/d	(1,404)	(1,741)	(3,145)
	9,796	884	10,860
Additions	_	_	

<sup>\*\*</sup> The obligation appears to be probable rather than possible. Hence treated as a provision rather than disclosed as a contingent liability as per IAS 37.

	Disposals (NBV) (210 – 205)		(5)	(5)
	Dep'n charge for year			
	• 11,200 × 3%	(336)		(336) (819)
	• (2,625 – 210) × 20%		(483)	(483)
		9,460	396	9,856
	Revaluation (Bal.fig)	40		40
	Net book value	9,500	396	9,896
3	Debenture interest			
				K'000
	Per TB – 1/2 year			50
	Accruals – further ½ year			50
	P/L charge for year			100
4	Deferred tax liability			
				K'000
	As per TB			256
	increase for year			25
	Amount required for statement of			
	financial position			281
5	Investment properties			
				K'000
	Opening valuation			492
	Increase in value			30
	Closing valuation			522
6	Disposals account			
				1/1000
	0 1 1 11			K'000
	Cost of asset sold			210
	Depreciation thereon			(205)
	Book value			5
	Proceeds			11
	Profit on disposal			6

# Solution 2

1	(a)	Cost of control in Sable:	K'000	K'000
		Consideration		
		Shares (18,000 $\times$ 2/3 $\times$ K5·75)		69,000
		Cash payment (18,000 × 2·42)		43,560
				112,560
		Less		
		Equity shares	24,000	
		Pre-acquisition reserves:		
		At 1 April 2007	69,000	
		To date of acquisition (13,500 $\times$ 4/12)	4,500	
		Fair value adjustments (4,100 + 2,400)	6,500	
		104,000 × 75% *	104,000	(78,000)
		Goodwill		34,560

<sup>\*</sup> The acquisition of 18 million out of a total of 24 million equity shares is a 75% interest.

# (b) Puku Group

# Consolidated income statement for the year ended 31 March 2008

	K'000
Revenue (150,000 + (78,000 x 8/12) – (10,000 intra group))	192,000
Cost of sales (w (i))	(119,100)
Gross profit	72,900
Distribution costs (7,400 + (3,000 x 8/12))	(9,400)
Administrative expenses (12,500 + (6,000 x 8/12))	(16,500)
Finance costs (w (ii))	(2,600)
Impairment of goodwill	(2,000)
Share of profit from associate (6,000 x 30%)	1,800
Profit before tax	44,200
Income tax expense (10,400 + (3,600 x 8/12))	(12,800)
Profit for the year	31,400
Attributable to:	
Owners of the parent	29,300
Non-controlling interests (w (iii))	2,100
	31,400

(c) An associate is defined by IAS 28 Investments in Associates as an investment over which an investor has significant influence. There are several indicators of significant influence, but the most important are usually considered to be a holding of 20% or more of the voting shares and board representation. Therefore it was reasonable to assume that the investment in Antelope (at 31 March 2008) represented an associate and was correctly accounted for under the equity accounting method.

The current position (from May 2008) is that although Puku still owns 30% of Antelope's shares, Antelope has become a subsidiary of Eland as it has acquired 60% of Antelope's shares. Antelope is now under the control of Eland (part of the definition of being a subsidiary), therefore it is difficult to see how Puku can now exert significant influence over Antelope. The fact that Puku has lost its seat on Antelope's board seems to reinforce this point. In these circumstances the investment in Antelope falls to be treated under IAS 39 Financial Instruments: Recognition and Measurement. It will cease to be equity accounted from the date of loss of significant influence. Its carrying amount at that date will be its initial recognition value under IAS 39 and thereafter it will be carried at fair value.

# **Workings**

(i)	Cost of sales	K'000	K'000
	Puku		94,000
	Sable (51,000 × 8/12)		34,000
	Intra group purchases (10,000)		(10,000)
	Additional depreciation: plant		
	$(2,400/4 \text{ years } \times 8/12)$	400	
	property (per question)	200	
			600
	Unrealised profit in inventories (3,000 $ imes$ 20/120)		500
			119,100

**Note:** for both sales revenues and cost of sales, only the post acquisition intra group trading should be eliminated.

#### (ii) Finance costs

	K'000
Puku per question	2,000
Sable (900 × 8/12)	600
	2,600

(iii)	Non-controlling interests (Minority interests)		
	Sable's post acquisition profit (13,500 $\times$ 8/12)	9,000	
	Less post acquisition additional depreciation (w (i))	(600)	
		8,400	× 25% = 2,100

# Solution 3

# (a) Statement of Cash flows for Chimwemwe plc for the year ended 31 March 2008 Cash flows from operating activities

	K'000	K'000
Profit before tax	3,212	
Adjustment for:		
Depreciation (W2)	1,300	
Amortisation (400+600-600)	400	
Profit on disposal of PPE (500-200)	(300)	
Interest expense	640	
Interest receivable	(100)	
Operating profit before working capital changes	5,152	
Working capital changes	0	
Cash generated from operations	5,152	
Interest paid	(640)	
Tax paid	(1,300)	
Net Cash from operating activities		3,212
Cash flows from investing activities		
Purchase of intangibles(1,400-800)	(600)	
Purchase of Property, Plant and Equipment (W1)	(3,200)	
Proceeds of sale of property, Plant and Equipment	500	
Purchase of non-current asset investments (800-400)	(400)	
Proceeds of sale of current asset investments	188	
Interest received	100	
Net cash used in investing activities		(3,412)
Cash flows from financing activities		
Issue of shares (6,000-4,000)+(1,716-1,200)	2,516	
Dividend paid	(800)	
Net Cash from operating activities		1,716
Increase in cash and cash equivalent		1,516
Cash and cash equivalents at 1 April 2007		0
Cash and Cash equivalents at 31 March 2008		1,516

# **Workings**

## (1) P, P & E © NBV

	K'000		K'000
Bal b/d	6,000	Disposal	1,200
Revaluation	2,000		
Purchase (Bal figure)	3,200	Bal C/d	10,200
	11,200		11,200

# (2) Accumulate Dep on P, P & E

	K'000		K'000
		Bal b/d	2,800
Depreciations on		Depreciation for t	he
disposed asset	1,000	year Bal. figure	1,300
C/d	3,100		
	4,100		4,100

## (b) Changes in cash flow and position

During the year cash has increased from zero to K1,516,000. Chimwemwe is reporting a profit from operations during the year which according to the cash flow statement is backed by operating cash. Chimwemwe seems to be carrying transactions on cash basis as net profit is equal to net cash from operating activities.

### Other things to note

The business had no inventories, no receivables and payables. IT system may have been in use. If this is not the case, further information would be required surrounding this working capital.

A huge drain on cash during the year can be seen when looking at investing activities section. Intangible assets, investment and plant and equipment have been purchased part of the purchase was financed by sale of property, plant and equipment and current investments. Current investments were sold an Net book value.

This resulted into net cash outflow of K3,412,000. This huge drain on cash now will have a positive impact on performance in the future.

Cash has also been raised through an issue of shares which is a positive sign as investors are still willing to invest in the business. However, shareholders are demanding so equity finance is often seen as being more expensive than debt finance. Furthermore, from cash flow point of view, interest payments are tax deductible where as dividends are not.

#### Conclusion

During the current year activities had a favorable effect on cash. The major drain was from investing activities. Further more, a substantial dividend has been paid during the year which was sufficiently covered by operating cash.

# Solution 4

# Realisation account

	ation account	
K'000		K'000
4,000	Payables	10,000
6,000	Loan from Zwide	1,000
10,000	Cash and bank proceeds	
14,000	Equipment	3,300
	Motor vehicles	5,500
9,000	Receivables	11,300
800	Investments	13,400
1,000	Lobengula's account	
	(Equipment)	750
300		
150		
45,250		45,250
	<b>K'000</b> 4,000 6,000 10,000 14,000 9,000 800 1,000 300 150	K'000  4,000 Payables  6,000 Loan from Zwide  10,000 Cash and bank proceeds  14,000 Equipment  Motor vehicles  9,000 Receivables  1,000 Lobengula's account  (Equipment)  300  150

# Partnership capital accounts

	Mzilikazi	Lobengula		Mzilikazi	Lobengula
	K'000	K'000		K'000	K'000
Realisation a/c			Capital accounts		
(equip)		750	Balance b/f	10,000	7,000
Cash	15,300	8,900	Current accounts		
			Balance b/f	4,000	2,500
			Loan from Zwide	1,000	
			Realisation a/c	300	150_
	15,300	9,650		15,300	9,650

# Cash and bank

	K'000		K'000
Balance b/f	500	Realisation account:	
Equipment	3,300	Payables settled	9,000
Motor vehicles	5,500	Dissolution expenses	800
Receivables	11,300	Partners' accounts:	
Investments	13,400	Mzilikazi	15,300
		Lobengula	8,900
	34,000		34,000

Solution 5
Income statements for the year ended 31 May 2008

	Head office K'000	Branch K'000	Combined entity K'000
Sales	229,700	199,700	429,400
Transfers to branch	154,000		
Opening Inventory	(48,500)	(15,400)	(62,500)
Purchases	(255,000)		(255,000)
Transfers from head office		(148,500)	
Closing inventory	_54,500	_17,600_	75,500
Gross profit	134,700	53,400	187,400
Expenses	(46,900)	(13,100)	(60,500)
Expenses re-charged		(500)	
Increase in provision for unrealised profit	(700)		
	87,100	39,800	126,900
Transfer of profit to head office	39,800	(39,800)	
	<u>126,900</u>		<u>126,900</u>

# Statements of financial position as at 31 May 2008

	Head office K'000	Branch K'000	Combined entity K'000
Non current assets		74,200	74,200
Inventory	54,500	17,600	75,500
Goods in transit (5,500 -500)	5000		
Cash	3,000		
Cash in transit	3,000		
Current account (91,800 – 1600)	90,200		
Current account		(91,800)	
	152,700		152,700
Retained earnings			
Balance b/f	25,800	_	25,800
Profit for the period	126,900	_	126,900
	152,700		152,700

# Workings:

# (1) Head office books

# **Current account with branch**

	K'000		K'000
Balance b/f	60,500	Goods in transit	5,500
Profit	39,800	Cash in transit	3,000
		Balance c/d	91,800
	100,300		100,300
2) Branch books			

# Current account with head office

	K'000		K'000
Balance c/d	91,800	Balance b/d	51,500
Profit		Expense recharge	500
		Profit	39,800
Motor vehicles	91,800		91,800
3) Unrealised profit			

# Provision for unrealised profit

	K'000		K'000
Balance c/d:		Balance b/d	1,400
Goods in transit (5,500 × 10/110)	500	Increased in provision during the year	700
Stocks at branch	<u>1,600</u> <u>2,100</u>		2,100

#### Solution 6

(a) AS 38 Intangible Assets defines research and development expenditure as follows:

Research: original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development: the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

- (b) Apart from the cost of non-current assets acquired or constructed in order to provide facilities for research and development activities over a number of accounting periods, IAS 38 requires development expenditure to be capitalised provided an entity can demonstrate all of the following:
  - (i) the technical feasibility of the project
  - (ii) the intention to complete the project and use or sell it
  - (iii) the ability to use or sell the item
  - (iv) how the project will generate probable future economic benefits
  - (v) the availability of adequate technical, financial and other resources to complete the project.
  - (vi) the ability to measure the expenditure reliably.
- (c) The need for an accounting standard with respect to expenditure on research and development arose from a number of factors. Firstly in many instances the sums expended were of a substantial nature and their treatment in the financial statements could have a material effect on the view shown by such statements. In many instances companies with substantial research and development expenditure shown on their statement of financial position had failed to survive in order to complete the projects involved.

The second effect of capitalising research and development expenditure is to apparently

'improve' the reported profits and earnings of those companies adopting this treatment. Thirdly the disclosure of the total amount expended and/or written off in an accounting period will enable users to assess the company's investment in the future.

Fourthly, the immediate write off of expenditure on the development of commercially successful products leads to the short term understatement of both profit and assets.

- (d) IAS 38 Intangible Assets splits research and development expenditure into two categories: Research expenditure and development expenditure. Research expenditure should be written off as incurred; development expenditure should be carried forward as an asset if all of the following can be demonstrated:
  - (i) the technical feasibility of the project;
  - (ii) the intention to complete the project and use or sell it;
  - (iii) the ability to use or sell the item;

- (iv) how the project will generate probable future economic benefits;
- (v) the availability of adequate technical, financial and other resources to complete the project;
- (vi) the ability to measure the expenditure reliably.
- (e) The new pulping process does seem to satisfy the conditions listed above, so the costs to date should be carried forward in the statement of financial position as an intangible non-current asset.
- (f) The attempt to develop a new species of tree definitely fails to satisfy the conditions listed above. It is not commercially viable and may not overall recover its costs, so expenditures on the project should be written off as incurred. There is no option to defer any of the related costs to future accounting periods.



# ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS CHARTERED ACCOUNTANTS EXAMINATIONS

# LICENTIATE LEVEL

L1: FINANCIAL REPORTING

**SERIES: DECEMBER 2010** 

TOTAL MARKS - 100 TIME ALLOWED: THREE (3) HOURS

#### INSTRUCTIONS TO CANDIDATES

- 1. You have ten (10) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
- 2. This paper is divided into TWO sections:

Section A: Attempt this ONE question.

Section B: Attempt THREE questions only.

- 3 Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
- Do NOT write in pencil (except for graphs and diagrams).
- 5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
- 6. All workings must be done in the answer booklet.
- 7. Present legible and tidy work.
- 8. Graph paper (if required) is provided at the end of the answer booklet.

#### **SECTION A:**

# Attempt this compulsory question in this section.

## Question 1

(a) IAS 28: Investment in Associates prescribes the accounting of investments in associates.

# Required:

Explain what an associate investment is and state how it is accounted for under IAS 28: Investment in Associates. (3 marks)

(b) You have been presented with the following draft Statements of Financial Position for three entities: **P. S** and **A**:

# Draft Statements of Financial Position as at 31st December 2009

	P Co <u>K'000</u>	S Co <u>K'000</u>	A Co <u>K'000</u>
Assets			
Non-current Assets			
Property, Plant and Equipment	160,000	192,000	139,760
Investments	332,000		
Total Non-current Assets	492,000	192,000	139,760
Current Assets			
Inventory	22,000	48,000	34,772
Current Account with S	32,000	_	_
Trade Receivables	78,000	44,000	40,424
Cash and Cash Equivalents	4,000	12,000	12,132
Total Assets	628,000	296,000	227,088
Equity and Liabilities			
Equity Shares of K1 each	400,000	160,000	80,000
Retained Earnings	84,000	52,000	31,200
	484,000	212,000	111,200
Non-current Liabilities			
12% Loan Notes	104,000	40,000	40,000
Current Liabilities			
Trade Payables	40,000	20,000	75,888
Current Account with P		24,000	
Total Equity and Liabilities	628,000	296,000	227,088

The following information is relevant:

- (i) On 1<sup>st</sup> January 2009, P acquired 128 million equity shares of S for K240 million. At the date of acquisition, S's retained earnings were K25.6 million. On the same date, P issued 12% loan notes to S, redeemable in 5 years time.
  - **P** also purchased 32 million shares of **A's** equity shares for K52 million; when **A's** retained earnings were K84 million.
- (ii) At the time of **P's** acquisition of **S**, the fair value of **S's** property, plant and equipment exceeded book values by K4 million, attributable to buildings. The said buildings had a remaining life of 20 years at the time.
- (iii) Loan interest due at 31st December 2009 was K1 million. Both **P** and **S** had accrued this amount at year end.
- (iv) On 27th December 2009, S had sent a cheque to P for K8 million. P only received this cheque on 5th January 2010.
- (v) During the year, **P** sold goods to **S** for K16 million at a mark-up of one-third. All these goods were unsold by year-end and the invoice for the same remained unpaid on 31st December 2009.
- (vi) Non Controlling Interest is valued using the proportion of net assets method.
- (vii) At 31st December 2009, goodwill in **S** was impaired by K37,920,000.00; while there was no goodwill impairment in **A**.

#### Required:

Prepare a Consolidated Statement of Financial Position for P Group as at 31st December 2009, in accordance with requirements of International Financial Reporting Standards (IFRSs).

[Notes to accounts are not required, but all workings should be clearly shown and appropriately referenced]. (22 marks)

[Total: 25 marks]

## **SECTION B:**

Attempt any Three (3) questions in this section.

# Question 2

The trial balance below was extracted from PROFED Learning Media (PROFED), an emerging institution engaged in provision of professional accountancy training in Zambia:

# Trial Balance as at 31st December 2009

	K'000	K'000
Revenue from tuition fees		458,240
Cost of sales (note 1)	411,060	
Loan interest paid	2,500	
Distribution expenses	13,600	
Administration expenses	96,400	
Land and buildings, of which Land K32 million (note 1)	132,000	
Equipment (note 1)	60,000	
Leased Lecture Theatre 1 Jan. 2009 (note 2)	33,280	
Accumulated Depreciation on 1 Jan. 2009:		
Buildings		20,000
Equipment		36,000
Equity Shares of 50 Ngwee each at 1 Jan. 2009		48,000
Share Premium at 1 Jan. 2009		9,600
Retained Earnings at 1 Jan. 2009		27,200
10% Loan Notes (note 3)		64,000
10% Redeemable Preference Shares		80,000
Lease rental paid at 1 Jan. 2009	9,600	
Income Tax (note 4)		320
Deferred Tax (note 4)		8,960
Inventory (note 6)	1,840	
Trade Receivables	26,400	
Trade Payables		9,672
Lease Obligations at 1 Jan. 2009		34,560
Suspense Account Balance (note 5)		12,288
Cash and Cash Equivalents	22,160	
	808,840	808,840

The following information is also made available:

- On 31st March 2009, PROFED completed building an ultra modern lecture theatre at a total cost of K350 million, charged to cost of sales. At a joint ceremony to commission the theatre and celebrate PROFED's fifth anniversary, an expert advised that the lecture theatre's lifespan was 25 years.
  - Other buildings had an estimated life of 40 years when they were acquired and are being depreciated on straight-line basis. Equipment is depreciated at 20% per annum using reducing balance method. PROFED charges depreciation of both buildings and plant to cost of sales.
- In order to overcome shortage of classroom accommodation due to high enrolment, *PROFED* took a 5-year finance lease of a lecture theatre on 1<sup>st</sup> January 2008. The cash price and fair value of this property was K41.6 million. Under terms of this lease, *PROFED* was to make annual advance payments of K9.6 million each. The annual interest rate implicit in the lease is 8%. *PROFED*'s depreciation policy on plant is 20% per annum on cost.
- The 10% loan note was issued on 30th June 2009 and is redeemable in 2012.
- The income tax balance in the trial balance relates to over provision on provisional corporation tax for year ended 31st December 2008. *PROFED* estimated that corporation tax for year ended 31st December 2009 is K14.6 million. Changes in the tax base of *PROFED*'s assets led to the deferred tax balance at 31st December 2009 reducing by K1.5 million.
- The suspense account arose from incorrect double entry accounting for a fully subscribed rights issue on 31<sup>st</sup> March 2009. *PROFED*'s accountant had correctly debited proceeds of this rights issue in which one share for every five held was issued at a price of 64 Ngwee per share.
- Inventory as at 31st December 2009 was correctly valued at K1.84 million. Included in this amount was a single class of inventory valued at its cost of K368,000 at 31st December 2009. Early in January 2010, the whole of this inventory was sold for K320,000 before subtracting selling costs of K48,000.

#### Required:

Prepare, in accordance with the requirements of the International Financial Reporting Standards (IFRSs) *PROFED's*,

(i) Income Statement for the year ended 31st December 2009. (10½ marks)

(ii) Statement of Changes in Equity for the year ended 31st December 2009. (3½ marks)

(iii) Statement of Financial Position as at 31st December 2009. (11 marks)

[Notes to accounts are not required, but clearly show all your workings.]

[Total: 25 marks]

# **Question 3**

(a) You are presented with the following extracts of financial statements relating to Sangwapo plc: Income Statement for the year ended 31st December 2009

		K'000
Revenue		5,283
Cost of sales and expenses		(2,784)
Operating Profit		2,499
Interest Charge		(330)
Profit before tax		2,169
Income Tax Expense		(720)
Profit for the year		1,449
Statement of Changes in Equity (extract) - year ended 31	st December 2009	
	Rev. Surplus	R/Earnings
	K'000	K'000
Balance @ 1 Jan 2009	120	3,630
Revaluation of Non-current Assets	330	_
Profit for the Year	_	1449
Dividends	_	(243)
Balance @ 31 Dec 2009	450	<b>4,</b> 836
Statements of Financial Position as at 31st December 20	09	
	2009	2008
	K'000	K'000
Assets		
Non-current Assets		
Intangible Assets (note 1)	4,245	2,451
Tangible Assets (note 2)	2,496	2,043

6,741

4,494

**Total Non-current Assets** 

Current Assets		
Inventory	1,857	2,103
Trade Receivables	1,572	1,476
Investments in Treasury Bills (note 3)	96	-
Other Investments (note 3)	1,092	375
Cash and Cash Equivalents	51	243
Total Assets	11,409	8,691
Equity and Liabilities		
Equity Shares of K1 each	1,500	900
Share Premium	936	852
Revaluation Surplus	450	120
Retained Earnings	4,836	3,630
	7,722	5,502
Non-current Liabilities		
5% Loan Notes	660	264
Provision for Court Case	219	150
Current Liabilities		
Trade Payables	1,551	1,587
Tax Payable	714	678
Interest Payable	300	90
Dividends Payable	243	420
Total Equity and Liabilities	11,409	8,691

# Notes to financial statements:

- 1 Intangible non-current assets represent deferred development expenditure. Amortisation on deferred development expenditure in 2009 amounted to K129,000.
- Additions to tangible non-current assets in the year under review amounted to K600,000. During the year, Sangwapo plc received K309,000 from sale of a tangible non-current asset, on which a loss of K18,000 was suffered.
- 3 Investments in treasury bills are cash equivalents; while other investments are not.

# Required:

- (a) Prepare Sangwapo plc's Statement of Cash flows for the year ended 31st December 2009, in accordance with requirements of IAS 7 (Statement of Cash flows). (15 marks)
- (b) Identify any five (5) users of Financial Statements that preparers of these statements should normally have in mind, and state two (2) benefits each of these identified users derive from ratio analysis. (10 Marks)

[Total: 25 marks]

#### Question 4

(a) Kache Kache Transporters Limited acquired a bus on 1 January 2009 through a 7 year lease from Institutional Credit Company (ICC), a leasing company. The present value of the minimum lease payments was K145 million and the fair value of the bus was K140 million. The expected useful life of the bus was 8 years. According to terms of this lease, Kache Kache paid a deposit of K3.68 million to be followed by 7 annual instalments of K28 million payable in arrears. The interest implicit in the lease was 10%.

#### Required:

- (i) To show extracts of accounting treatment for the above lease transaction in Kache Kache Transporters Limited's:
  - Income Statement for the year ended 31st December 2009. (5½ marks)
- (ii) Statement of Financial Position for the year ended 31st December 2009. (9½ marks)
- (b) The objective of IAS 37: Provisions, Contingent Liabilities and Contingent Assets; is to ensure appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets. IAS 37 also ensures that sufficient information is disclosed in the notes to financial statements to enable users understand their nature, timing and amount.

With reference to IAS 37: Provisions, Contingent Liabilities and Contingent Assets, define:

(i) A Provision. (1 mark)

(ii) A Contingent Liability. (2 marks)

(iii) A Contingent Asset. (2 marks)

- (iv) State the criteria (conditions) for recognising provisions in a firm's financial statements as set out by IAS 37. (3 marks)
- (v) Describe guidelines under IAS 37 for measuring provisions to recognise in an entity's financial statements. (2 marks)

[Total: 25 marks]

#### Question 5

Kapiri and Mposhi have been trading as partners for ten years now, sharing profits and losses in the ratio 2:1 respectively. Their Statement of Financial Position as at 31 December 2009 is as follows:

#### Statement of Financial Position as at 31st December 2009

#### Assets

Non-current Assets	K'000
Land and Buildings at Fair Value	27,000
Motor Vehicles at Net Book Value	13,500
Equipment at Cost	9,000
Total Non-current Assets	49,500
Current Assets	
Inventory	7,200
Trade Receivables	5,400
Cash and Cash Equivalents	900
Total Assets	63,000
Capital and Liabilities	
Capital Account Balances: Kapiri	28,800
Mposhi	14,400
	43,200
Current Account Balances: Kapiri	2,700
Mposhi	3,600
	49,500
Non-current Liabilities	
Loan Notes	9,000
Current Liabilities	
Trade Payables	4,500
Total Equity and Liabilities	63,000

In order to qualify for funds from the Citizen Economic Empowerment Commission (CEEC), the partners decided to formalise their business and converted the partnership into a Limited Company on 1 January 2010, registering it as Kapiri-Mposhi Limited on the same day. The new company management agreed to take over all assets at a purchase consideration of K72 million, payable by K54 million in shares of K1 in the new company at par, plus K18 million cash.

The partners will pay all partnership debts from their accounts. Shares in the new firm will be divided between the two partners in their profit sharing ratio.

# Required:

Prepare the following accounts to record conversion of the partnership into KAPIRI-MPOSHI Limited:

(a)	Realisation Account	(8 marks)
(b)	Cash and Cash Equivalents Account	(5 marks)
(c)	Partners' Current and Capital Accounts	(9 marks)
(d)	Equity Account (in KAPIRI-MPOSHI Ltd)	(3 marks)

[Total: 25 marks]

#### Question 6

(a) IAS 16: (Property, Plant and Equipment) prescribes accounting treatment of tangible non-current assets.

The data in the table below is an extract from the Non-current Asset Register of Cuundu Trading Limited as at 31st December 2009:

	Cost/Valuation Depreciation		Revaluation Surplus	
	K'000	K'000	K'000	
Land & Buildings (1st Jan. 09)	650,000	_	12,000	
Plant at 1st Jan. 09	640,000	160,000	_	

An inspection of the payables ledger revealed an outstanding amount of K120 million on an invoice dated 30<sup>th</sup> June 2009 due to Gonde Engineering Limited for supply of an item of plant which Cuundu Trading Limited commissioned on the date of the invoice.

Cuundu Trading Limited depreciates all plant at 12½% per annum, reducing balance.

Further, you are informed that Cuundu Trading Limited has a policy of revaluing Land and Buildings every 31<sup>st</sup> December. The valuation in the table above includes the land element at K150 million. The estimated remaining life of the building at 31<sup>st</sup> December 2008 was 20 years.

The professional valuer's certificate on 30<sup>th</sup> December 2009 retained the value of land at the last valuation figure, but showed the buildings' new value as K460 million.

#### Required:

- (a) Show extracts for exhaustive treatment of the above in Cuundu Trading Limited's Income Statement and Statement of Changes in Equity for the year ended 31st December 2009 as well as in the Statement of Financial Position as at 31st December 2009.
  - **NB.** Show all relevant workings as well as the disclosure format for movements in Non-current Assets. (15 marks)
- (b) Briefly explain the benefits and drawbacks of cash and accruals basis of accounting as applied in public sector accounting. (10 marks)

[Total: 25 Marks]

#### **END OF PAPER**

# DECEMBER 2010 L1: FINANCIAL REPORTING SUGGESTED SOLUTIONS

#### Solution 1

(a) An explanation of associate and accounting treatment thereof in consolidated financial statements.

IAS 28: Investments in Associates, defines an associate as an investment in which an investor has significant influence. Significant influence is usually ascertained by an investor holding between 20% and less than 50% of voting shares and board representation in investee.

IAS 28 requires associates to be accounted for in Consolidated Financial Statements using the Equity Method.

Under equity method, the parent should include its share of earnings in the associate whether or not the latter distributes earnings as dividend. This is achieved by adding the parent's share of the associate's profit after tax to the consolidated retained earnings of the parent.

In the statement of financial position, investment in associate is recorded initially at cost. In subsequent years, this investment will be shown at a value increased (or decreased) by the amount of the parent's share of the associate's retained earnings. (3 marks)

### (b) P Group

#### Statement of Financial Position as at 31st December 2009

Assets	K'000	K'000
Non-current Assets		
Property, Plant and Equipment (W2)	355,800	
Goodwill (W4)	50,400	
Investment in Associate	30,880	
		437,080
Current Assets		
Inventory (22+48-4)	66,000	
Trade Receivables (78+44-1-16)	105,000	
Cash and Cash Equivalents (4+12+8)	24,000	
		195,000
Total Assets		632,080

# Equity and Liabilities Equity

Equity Shares of K1 each	400,000	
Retained Earnings (W6)	41,920	
	441,920	
Non-Controlling Interest (W7)		43,160
Total Equity		485,080
Non-current Liabilities		
12% Loan Notes		104,000
Current Liabilities		
Trade Payables (40+20-1-16)		43,000
Total Equity and Liabilities		632.080

# Workings

1. Group structure

128m shares/160m shares = 80%

40%

2.	Property, Plant and Equipment	K'000
	P's Carrying Value of PPE	160,000
	S's Carrying value of PPE	192,000
	Fair value adjustment	4,000
	Less additional depreciation (K4m/20 yrs)	(200)
		355,800

### 3. Unrealised Profit

Selling Price >	< Margin, i.e. ½	4 (since all goods are	unsold)	4,000
-----------------	------------------	------------------------	---------	-------

4	Goodwill in S	K'000	K′000
	Consideration transferred		240,000

# Net assets acquired:

Equity Shares	160,000
Retained Earnings	25,600
Fair value adjustment	4,000
	189,600

Group share at 80%	(151,680)
Goodwill	88,320
Goodwill impairment	(37,920)
Goodwill to CSOFP	50,400

# 5. Investment in Associate

Ocat of investment in Associate (so non musetion)		F2 000		
Cost of investment in Associate (as per question)		5.	52,000	
Share of loss for the year [(31.2m-K84m) >	< 40%]	(21	,120)	
		3	0,880	
Group Retained Earnings	Р	S	Α	
Per question	84,000	52,000	31,200	
Less Pre-acquisition profits	_	(25,600)	(84,000)	
Unrealised profits (W3)	(4,000)	_	_	
Goodwill impairment	(37,920)			
Depreciation on Fair value adjustment		(200)	_	
	42,080	26,200	(52,800)	
Share in S (K26,200 × 80%)	20,960 ◄			
Share in A (-K52,800 × 40%)	<u>(21,120)</u> <b>▲</b> 41.920			
Non Controlling Interest (NCI) in S				
Equity Shares		160,00	00	
Retained Earnings		52,00	00	
Fair Value adjustment		4,00	00	
Additional Depreciation on fair value (K4m/20)	Additional Depreciation on fair value (K4m/20years)		0)	
		215,80	00	
NCI's Share (i.e. @ $20\% \times K215.8$ million)		43,16	60	
	Cost of investment in Associate (as per question   Share of loss for the year [(31.2m-K84m) >  Group Retained Earnings Per question Less Pre-acquisition profits Unrealised profits (W3) Goodwill impairment Depreciation on Fair value adjustment  Share in S (K26,200 × 80%) Share in A (-K52,800 × 40%)  Non Controlling Interest (NCI) in S Equity Shares Retained Earnings Fair Value adjustment Additional Depreciation on fair value (K4m/20)	Cost of investment in Associate (as per question) Share of loss for the year [(31.2m-K84m) × 40%]  Group Retained Earnings P Per question 84,000 Less Pre-acquisition profits — Unrealised profits (W3) (4,000) Goodwill impairment (37,920) Depreciation on Fair value adjustment — 42,080 Share in S (K26,200 × 80%) Share in A (-K52,800 × 40%) (21,120) 41,920  Non Controlling Interest (NCI) in S Equity Shares Retained Earnings Fair Value adjustment Additional Depreciation on fair value (K4m/20years)	Cost of investment in Associate (as per question)  Share of loss for the year [(31.2m-K84m) × 40%]  Group Retained Earnings Per question Less Pre-acquisition profits Unrealised profits (W3) Goodwill impairment Goodwill impairment Depreciation on Fair value adjustment  — (200) Share in S (K26,200 × 80%) Share in A (-K52,800 × 40%)  Non Controlling Interest (NCI) in S Equity Shares Retained Earnings Fair Value adjustment 4,00 Additional Depreciation on fair value (K4m/20years)  (215,80  52,000  (221,120) 41,920  160,000  7215,800  (200)  172,120 7215,800  (200)  183,000  184,000  18	

### Solution 2

# (i) PROFED Learning Media Income Statement for the Year Ended 31st December 2009

	K'000
Revenue	458,240
Cost of Sales (w1)	(87,276)
Gross Profit	370,964
Administration Expenses	(96,400)
Distribution Expenses	_(13,600)
Operating Profit	260,964
Finance Costs (w4)	(13,197)
Profit Before Tax	247,767
Taxation (K14,600,000-K320,000-K1,500,000)	(12,780)
Profit After Tax	234,987

# (ii) PROFED Learning Media

# Statement of Changes in Equity for Year Ended 31st December 2009

	Equity K'000	S/Premium K'000	R/Earnings K'000	Total K'000
		11 000		
Balance @ 1 Jan 2009	48,000	9,600	27,200	84,800
Issue of Shares	9,600	2,288	_	12,288
Profit for the Year			234,987	234,987
Balance @ 31 Dec 2009	57,600	12,288	262,187	332,075

# (iii) PROFED Learning Media

### Statement of Financial Position as at 31st December 2009

Assets	K'000	K'000
Non-current Assets		
Property, Plant and Equipment (W7)		493,160
Current Assets		
Inventory [K1,840,000-K96,000 (W5)]	1,744	
Trade Receivables	26,400	
Cash and Cash Equivalents	22,160	50,304
Total Assets		543,464

Equity and Liabilities		
Equity		
Equity Shares of K0.50 each		57,600
Share Premium		12,288
Retained Earnings		262,187
Total Equity		332,075
Non-current Liabilities		
10% Redeemable Preference Shares	80,000	
10% Loan Notes	64,000	
Deferred Tax (K8,960,000-K1,500,000)	7,460	
Lease Obligation exceeding 12 months (W3)	17,357	
		168,817

# **Current Liabilities**

Trade Payables	9,672
Current Tax	14,600
Accrued Finance Cost on Lease	1,997
Lease Obligation not exceeding 12 months [ $(K26.957 - 17.3570) - K1.997m$ ]	7,603
10% Loan Note Interest	700
10% Redeemable Preference Share Dividends (10% × K80m)	8,000
Total Equity and Liabilities	543,464

# **WORKINGS**

1.	Cost of Sales	K'000
	Per Question	411,060
	Less Cost of Lecture Theatre	(350,000)
	Depreciation (W2)	26,120
	Loss in Inventory (W5)	96
		87,276
2.	Depreciation	K'000
2.	<b>Depreciation</b> Buildings [(Old) K100,000,000/40 years]	<b>K'000</b> 2,500
2.	•	
2.	Buildings [(Old) K100,000,000/40 years]	2,500
2.	Buildings [(Old) K100,000,000/40 years] Buildings [(New) K350,000,000/25 years × 9/12]	2,500 10,500

		26,120
3.	Lease Amortisation Schedule	
	Fair value 1st Jan 2008	41,600
	1st Instalment - payment @ 1st Jan 2008	(9,600)
	Liability at 1st Jan 2008	32,000
	8% Interest at 31 Dec 2008	2,560
	Liability at 31st Dec 2008	34,560
	2 <sup>nd</sup> Instalment - payment @ 1 <sup>st</sup> Jan 2009	(9,600)
	Liability at 1st Jan 2009	24,960
	8% Interest at 31st Dec 2009	1,997
	Liability at 31st Dec 2009	26,957
	3 <sup>rd</sup> Instalment - payment @ 1 <sup>st</sup> Jan 2010	(9,600)
	Liability at 1st Jan 2010	17,357
4.	Finance Cost	
	10% × K64,000,000 × 6/12 = K3,200,000, Total Expense	3,200.000
	Less Payment	(2,500,000)
	K700,000; Accrued to SOFP.	700,000
	10% Preference Shares of K80 million gives Preference Dividend of K8,00	00,000

# 5. Inventory

The carrying amount of inventory of K368,000 should be written down by K96,000 to K272,000.

Hence, total finance costs=K3.2m + K8m + K1.997m (Lease interest) = K13.197m

# 6. Rights Issue

Equity value of K48 million represents 96 million shares (i.e. 48 million/K0.50). Number of rights shares = 19.2 million (96 million/5 shares). Rights issue records to clear Suspense figure should be:

Suspense (19.2 million shares $\times$ K0.64)	Dr K12,288,000
Equity (19.2 million shares × K0.50)	Cr K9,600,000
Share Premium (19.2 million shares × K0.14)	Cr K2,688,000

# 7. Non-current Assets

	Land &	Leased	Equipme	
	Buildings K'000	Asset K'000	K'000	Total K'000
Cost/Valuation				
Balance @ 1 Jan 2009	132,000	41,600	60,000	233,600
Additions	350,000			350,000
Balance @ 31 Dec 2009	482,000	41,600	60,000	583,600
Depreciation				
Balance @ 1 Jan 2009	20,000	8,320	36,000	64,320
Charge for the year (W2)	13,000	8,320	4,800	26,120
Balance @ 31 Dec 2009	33,000	16,640	40,800	90,440
NBV at 31 Dec 2009	449,000	24,960	19,200	493,160

# Solution 3

# (a) Sangwapo Plc

Statement of Cash Flows for Year Ended 31st December 2009

Statement of Cash Flows for Year Ended 31st December 2009		
	K'000	K'000
Cash Flows from Operating Activities		
Net Profit Before Taxation		2,169
Depreciation (W1)		150
Amortisation of Development Expenditure		129
Interest Expense		330
Movement in Allowance for Court Case (K0.219m-K0.150m)		69
Loss on Disposal of Tangible Non-current Asset		18
Operating Profit Before Changes in Working Capital		2,865
Decrease in Inventory (K2.103m-K1.857m)	246	
Increase in Receivables (K1.476m-K1.572m)	(96)	
Decrease in Payables (K1.587m-K1.551m)	(36)	114
Cash Generated from Operations		2,979
Interest paid (K0.09m+K0.33m-K0.3m)	(120)	
Dividend paid (K0.42m+K0.243m-K0.243m)	(420)	
Taxation paid (K0.678m+K0.72m-K0.714m)	(684)	(1,224)
Net Cash Flow from Operating Activities		1,755
Cash Flows from Investing Activities		
Purchase of Tangible Non Current Assets	(600)	
Purchase of Intangible Non Current Assets (W2)	(1,923)	
Purchase of Investments (K1.092m-K0.375m)	(717)	
Proceeds from Disposal of Non-Current Asset	309	
Net Cash Flow from Investing Activities		(2,931)
Cash Flows from Financing Activities		
Proceeds from Share Issue (K1.5m+K0.936m-K0.9m-K0.852m)	684	
Proceeds from Issue of Loan Notes (K0.66m-K0.264m)	396	
Net Cash Flow from Financing Activities		1,080_
Net Decrease in Cash and Cash Equivalents		(96)
Cash and Cash Equivalents at Start		243
Cash and Cash Equivalents at end (K0.051m+K0.096m)		147_

### Workings

### 1 Tangible Non-current Assets 2.

#### K'000 K'000 2,043 Disp. (309+18) 327 Balance b/d Bank (Additions) 600 Dep. (Bal. Fig.) 150 Revaluation 330 Balance c/d 2,496 2,973 2,973

#### **Intangible Non-current Assets**

	K'000		K'000
Balance b/d	2,451	Amortisation	129
Bank (Additions)	1,923	Balance c/d	4,245
	2,973		2,973

### (b) Identification of any five users of financial statements and their benefits from ratio analysis:

### (i) Shareholders

- To assess management performance.
- For investment decision making e.g. purchase or disposal of shares.
- Comparison of their return on investment with some benchmark.

#### (ii) Potential Investors

- For better yield identification compared with current market returns.
- To assess opportunity for acquisition of an entity for greater market share.

### (iii) Lenders (providers of debt capital)

- To assess financial strength of a target company.
- To review exposure to financial risk through gearing.
- To ascertain whether or not an entity would be able to service current or increased debt.

#### (iv) Employees

- Ratios form a basis for higher pay negotiations.
- For assessment of results of their efforts.

#### (v) Management

- Uses ratios to compare their own performance with industry average.
- Ratios enable management identify areas of improvement.
- Uses results of ratio analysis to justify decisions on request for pay rise.

# (vi) Suppliers

- Use ratios for their decisions to grant initial or further trade credit.
- Use ratios to assess whether or not an entity is a going concern.

# (vi) Government and its agencies

- Use ratio analysis for statistical planning purposes.
- For assessment of tax revenue.

# (vii) The Public

- Researchers and trade journalists use ratios for their various editorial needs.
- Society may want to know corporate social responsibility and corporate citizenship of the firm.

# Solution 4

# (a) (i) Kache Kache Transporters Ltd's

Incor	ne Statement	(EXTRACT)	Year Ended 31st	December 2009	
					K'000

COS (Depreciation on PPE: K140m/7 years) shorter of LP & ELA 20,000
Finance Costs - Lease Interest (W1) 13,632

K'000

# (ii) Kache Kache Transporters Ltd's

# Statement of Financial Position (EXTRACT) as at 31st December 2009

Ass	sets	K'000	K'000
Nor	n-current Assets		
Pro	perty, Plant and Equipment (K140m-K20m)		120,000
Nor	n-Current Liabilities		
Lea	se Obligation payable after 12 months (W1)		106,147
Cur	rent Liabilities		
Lea	se Obligation payable within 12 months (K28m-K1	2.195m)	15,805
Wo	rking		
			K'000
1	Fair Value on 1 January 2009		140,000
	Less Deposit on 1 January 2009		(3,680)
	Liability at 1 January 2009		136,320
	Balance (of Liability) on 1 January 2009		136,320
	Interest at 10% on 31 December 2009		13,632
	1st Instalment on 31 December 2009		(28,000)
	Balance on 1 January 2010		121,952
	Interest at 10% on 31 December 2010		12,195
	2nd Instalment on 31 December 2010		(28,000)
	Balance on 1 January 2011		106,147

- **(b)** (i) A Provision is a liability of uncertain timing and amount.
  - (ii) A Contingent Liability is a possible obligation arising from past events and whose existence will be confirmed only by occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
  - (iii) A Contingent Asset is a possible asset that arises from past events and whose existence will be confirmed only by occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
  - (iv) A provision should be recognised when, and only when:
    - (a) An entity has a present obligation (legal or constructive) as a result of past events.
    - (b) It is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and
    - (c) A reliable estimate can be made of the amount of the obligation.
  - (v) The amount recognised as provision should be measured as the best estimate of the expenditure required to settled the present obligation at the reporting date or to transfer it to a third party at that time.

# **Solution 5**

# (a) REALISATION ACCOUNT

	K'000		K'000
Buildings	27,000	Kapiri-Mposhi Ltd	72,000
Motor vehicles	13,500		
Equipment	9,000		
Inventory	7,200		
Trade Receivables	5,400		
Share of profit on Realisation:			
Kapiri <sup>2</sup> / <sub>3</sub>	6,600		
Mposhi <sup>1</sup> / <sub>3</sub>	3,300		
	72,000		72,000

# (b) CASH AND CASH EQUIVALENTS ACCOUNT

	K'000		K'000
Balance b/d	900	Capital - Kapiri	11,100
Kapiri-Mposhi Ltd	18,000	- Mposhi	7,800
	18,900		18,900

# c) PARTNERS' CURRENT AND CAPITAL ACCOUNTS

	KAPIRI	MPOSHI		KAPIRI	MPOSHI
	K'000	K'000		K'000	K'000
Shares in KAPIRI Ltd	36,000	18,000	Capital a/c balances	28,800	14,400
			Current a/c balances	2,700	3,600
Cash &			Profit on Realisation	6,600	3,300
Cash	11,100	7,800	Loan notes	6,000	3,000
equivalent			Payables	3,000	1,500
	47,100	2,800		47,100	25,800

# (d) EQUITY ACCOUNT: KAPIRI-MPOSHI LTD

	K'000			K'000
Balance c/d	54,000	Capital a/cs	Kapiri	36,000
			Mposhi	18,000
	54,000			54,000

#### Solution 6

#### (a) (i) **Cuundu Trading Ltd**

### Income Statement (EXTRACT) Year Ended 31st December 2009

	K'000	K'000
Cost of sales (Depreciation on PPE - W1)		92,500
Excess on Revaluation deficit		3,000

#### **Cuundu Trading Ltd** (ii) Statement of Changes in Equity (EXTRACT) Year Ended 31st December 2009

	Equity	R/Surplus	R/Earnings	Total
	K'000	K'000	K'000	K'000
Balance @ 1 Jan 2009	_	12,000	_	12,000
Revaluation of deficit (maximum)		(12,000)		(12,000)
		<u> </u>		

# (iii) Cuundu Trading Ltd

# Statement of Financial Position (EXTRACT) as at 31st December 2009

Assets	K'000
Non-current Assets	
Property, Plant and Equipment (W3)	1,142,000
Current Liabilities	
Payable for item of Plant	120,000

### **WORKINGS**

# **Plant Depreciation**

Old (640,000,000-K160,000,000 × 121/2%)	60,000
New (120,000,000 $\times$ 12½% $\times$ 6/12)	7,500
	67,500

#### **Land and Buildings Valuation Schedule** 2.

Fair value at 1st Jan 2009	650,000
Depreciation [Buildings only: (K650m – K150m)/20 years]	(25,000)
Revaluation loss	(15,000)
Fair value at 31st Dec 2009	610,000

#### 3. Non-current Assets

	Land &	Plant	<b>-</b>
	Buildings	1/1000	Total
	K'000	K'000	K'000
Cost/Valuation			
Balance @ 1 Jan 2009	650,000	640,000	1,290,000
Additions	_	120,000	120,000
Revaluations	(15,000)	_	(15,000)
Balance @ 31 Dec 2009	635,000	760,000	1,395,000
Depreciation			
Balance @ 1 Jan 2009	-	160,000	160,000
Charge for the year	25,000	67,500	92,500
Balance @ 31 Dec 2009	25,000	227,500	252,500
NBV			
At 1 Jan 2009	650,000	480,000	1,130,000
At 31 Dec 2009	610,000	532,500	1,142,500

### (b) (i) Accrual Basis Accounting Versus Cash Basis Accounting

### The Cash basis of accounting

**Cash accounting**, which is also known as **cash basis accounting**, allows for the recognition of income at the time it is actually **received**. This means that invoiced income is not counted as an asset until payment for the invoice is actually in hand. The same approach is applied to debits, in that any expenses incurred are not posted until they are paid.

The cash basis of accounting recognises transactions and events only when **cash has been received or paid.** The **elements** of the financial statements will be **cash receipts**, **cash** disbursements and cash balances.

#### The full Accrual Basis of accounting

In contrast, accrual accounting does recognise income at the time it is earned. As goods or services are invoiced, the invoices are posted and counted as assets. They remain in this state until the face value of the invoice is credited for some reason. In like manner, any expenses are also posted at the time they are incurred or an invoice for those expenses is received, and remains open until the expenses are paid. Accrual basis means a basis of accounting under which transactions and other events are **recognised when they occur** (and not only when cash or its equivalent is received or paid). The general idea is that

economic events are recognized by matching revenues to expenses (the matching principle) at the time in which the transaction occurs rather than when payment is made (or received). This method allows the current cash inflows/outflows to be combined with future expected cash inflows/outflows to give a more accurate picture of a company's current financial condition. The **elements** recognized under accrual accounting are **assets, liabilities, net assets/equity, revenue and expenses.** 

#### Advantages and disadvantages of the cash method.

Cash accounting is **simpler** to maintain, **easier to understand**, and **simplifies tax filing** by allowing individuals or businesses to take deductions for business expenses paid in cash, while paying tax on revenues only received in cash. When individuals or businesses use the cash accounting method, the income statement shows the same cash increase or decrease as the cash flow statement.

Though the cash method provides a more accurate picture of how much actual cash your business has, it may offer a **misleading picture of longer-term profitability**. Under the cash method, for instance, your books may show one month to be spectacularly profitable, when actually sales have been slow and, by coincidence, a lot of credit customers paid their bills in that month. Cash-based accounting can distort the true operations of your business, and incorrectly **reflect income**, for example, if in a given period you collect little or no receivables and you pay lots of bills, under the cash-accounting method, you have expense without income you've lost money. On the other hand, if you collect a lot of money and don't pay your bills, you have big income. That's a major distortion of what actually occurred.

### Advantages and disadvantages of the accrual method.

Accrual accounting is considered to be the **standard accounting practice** for most companies. Accrual accounting, on the other hand, provides more timely information since revenues and expenses are recorded when they occur. This follows the matching principle, which requires companies to report all revenue with the expenses that were required to generate that revenue for the period. Accrual accounting is also the reason double entry accounting is required, since not all transactions necessarily affect the cash account, as is the case in cash accounting.

This method provides a more **accurate picture** of the company's current condition, but its relative **complexity makes it more expensive to implement.** Further more, accrual accounting may leave you in the **dark as to what cash reserves are available,** which could result in a serious cash flow problem. For instance, your income ledger may show

thousands . of kwacha in sales, while in reality your bank account is empty because your customers haven't paid you yet.

Under accrual accounting method, net income does not necessarily equal cash.



# ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS CHARTERED ACCOUNTANTS EXAMINATIONS

### LICENTIATE LEVEL

L1: FINANCIAL REPORTING

**SERIES: JUNE 2011** 

TOTAL MARKS - 100 TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

- 1. You have ten (10) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
- 2. This paper is divided into TWO sections:

Section A: Attempt this ONE question.

Section B:Attempt THREE questions only.

- 3 Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
- 4. Do NOT write in pencil (except for graphs and diagrams).
- 5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
- 6. All workings must be done in the answer booklet.
- 7. Present legible and tidy work.
- 8. Graph paper (if required) is provided at the end of the answer booklet.

### **SECTION A**

Attempt this one compulsory question in this section.

### Question 1

*Chachacha* Limited, who prepares its Financial Statements in accordance with International Financial Reporting Standards (*IFRSs*), extracted a Trial Balance for the year ended 31<sup>st</sup> March 2011 as shown below:

	K'000	K'000
Revenue		304,000
Cost of sales	197,440	
Distribution costs	13,920	
Administrative expenses (note (i))	40,400	
Loan interest paid (note (ii))	1,920	
Investment income		1,040
Profit on sale of Investments (note (iv))		1,760
Freehold Property - at cost 1 April 2002 (note (vi))	50,400	
Plant and Equipment - at cost (note (vi))	33,760	
Machinery - at cost on 1 April 2008 (note (vi))	80,000	
Accumulated depreciation 1 April 2010 :Buildings		6,400
: Plant and Equipment		15,760
:Machinery	04.000	32,000
Available-for-sale investments (note (iv)) Inventory at 31 March 2011 (note (iii))	21,200 22,400	
Trade receivables	34,394	
Cash and Cash Equivalents	4,614	
Trade payables		30,320
Equity shares of K20 each		50,000
12% Loan Note, redeemable in 2014 (note (ii))		18,000
Retained earnings at 1 April 2010		32,848
Other reserves (note (iv))		4,000
Deferred Tax (note (v))		4,320
	500,448	500,448

The following additional information is also made available:

- (i) During the year, *Chachacha* Limited paid an equity dividend of K2.00 per share and this amount is included in the administrative expenses figure in the trial balance.
- (ii) The 12% Redeemable Loan note was issued for proceeds of K16 million on 1<sup>st</sup> April 2009. It has an effective interest rate of 18% due to the value of its redemption.
- (iii) The trial balance inventory figure includes an identifiable inventory item with a cost of K8.4 million. Management of *Chachacha* Limited has advised that even though this item is damaged, an active scrap market exists for which K9.7 million sale proceeds would be received and K4.6 million spent to put this inventory in a saleable condition.
- (iv) During the current year, *Chachacha* Limited sold an available-for-sale investment for K8.8 million. At the date of this sale, the said investment which had originally cost K5.6 million had a carrying amount of K7.040 million. *Chachacha* Limited has recorded this disposal in its books. The remaining available-for-sale investments in the trial balance (of K21.2 million) have a fair value of K23.2 million at 31st March 2011. Other reserves in the trial balance represent the net increase in the value of Available-for-sale investments as at 31st March 2011. Ignore deferred tax on these transactions.
- (v) Directors of Chachacha Limited have estimated the provision for income tax for the year ended 31st March 2011 at K12.96 million. At the same date, the deferred tax provision was adjusted to a credit balance of K7.44 million due to a change in the value of the net assets.
- (vi) The Freehold property has a land element of K10.4 million. The building element is being depreciated on a straight-line basis.

Plant and equipment is depreciated at 40% per annum, reducing balance method.

Chachacha Limited's Machinery is depreciated over its useful life of 5 years on straight line basis, and management has adopted a revaluation policy for its Machinery to suit the kind of business the company is engaged in. On 1st October 2010, Chachacha Limited decided to revalue its Machinery to K88 million and its useful economic life at the time of valuation was estimated to be 4 years. It is the company's policy to charge depreciation on its Machinery proportionately.

No depreciation has yet been charged on any non-current asset for the year ended 31st March 2011. Depreciation, amortisation and impairment are all charged to cost of sales.

#### Required:

- (a) Prepare *Chachacha* Limited's Statement of Comprehensive Income and Statement of Changes in Equity for the year ended 3st 1 March 2011. (15 marks)
- (b) Prepare Chachacha Limited's Statement of Financial Position at 31st March 2011.

(10 marks)

Notes to the financial statements are not required.

(Total: 25 marks)

### **SECTION B**

Attempt any three questions only in this Section.

#### Question 2

#### **Pride PIc** made the following equity investments:

On 1<sup>st</sup> April 2010, 12.8 million of the 16.0 million, K1 issued share capital of **Self-esteem** through a share exchange of three shares in **Pride** for every five shares in **Self-esteem**, plus a cash payment of K2 per **Self-esteem** share payable in three years' time. The market price per share of **Pride's** shares on 1 April 2010 was K4, and the group's cost of capital on the same date was estimated at 6% per annum.

On 1<sup>st</sup> January 2011, 4.8 million of the 12 million, issued equity shares of **Arrogance**, paying K2.40 per share in cash. On the same date, **Pride** issued 15% Loan notes to shareholders of **Arrogance** on the basis of K100 Loan note for every 100 shares acquired.

The separate Income Statements of the three companies for the year ended 31 March 2011 are given below:

Pride	Self-esteem	Arrogance
K'000	K'000	K'000
84,000	49,600	40,000
(54,400)	(29,200)	(48,800)
	<u> </u>	
29,600	20,400	(8,800)
320	(0)	(0)
(3,200)	(1,600)	(3,600)
(6,000)	(5,600)	(6,800)
(960)	(720)	(0)
19,760	12,480	(19,200)
(6,960)	(2,080)	3,200
12,800	10,400	(16,000)
	<b>K'000</b> 84,000 (54,400)  29,600 320 (3,200) (6,000) (960) 19,760 (6,960)	K'000       K'000         84,000       49,600         (54,400)       (29,200)         29,600       20,400         320       (0)         (3,200)       (1,600)         (6,000)       (5,600)         19,760       12,480         (6,960)       (2,080)

You are also given the following information:

- (i) No fair value adjustments were needed on the date of acquisition of Arrogance; while the fair values of Land, Plant and Development Expenditure, exceeded their book values by K2.4 million, K4.0 million and K3.2 million respectively, on the date Self-esteem was acquired. Further, the Plant had a useful life of five years at the date of this acquisition and Development Expenditure which qualified as an intangible non-current asset was still in development. Self-esteem had not yet incorporated these fair value adjustments in its financial statements and management has advised that depreciation on Plant is chargeable to cost of sales.
- (ii) The retained earnings of **Self-esteem** and **Arrogance** at 1<sup>st</sup> April 2010 were K14.4 million and K28.0 million respectively.
- (iii) During the year under review, Pride sold goods to **Self-esteem** at a selling price of K14.4 million, making a profit of 25% on cost. At 31st March 2011, K6 million of these goods were still in *Self-esteem's* inventories.
- (iv) Other Income in Pride's Income Statement represents dividend received from Self-esteem on 30<sup>th</sup> April 2011.
- (v) You are to assume that trading profits and losses of the above firms accrue evenly throughout the year.
- (vi) On 31st March 2011, impairment tests for both Self-esteem and Arrogance were conducted. At that date, it was resolved that the subsidiary's goodwill be written-down by 20% of its value at acquisition; while the investment in Associate was to be equal to K14 million, due to the associate's continued losses since acquisition.
- (vii) Assume that the present value of K1 receivable in three years' time at 6% discount rate is 0.840 **Required:** 
  - (a) Prepare the Consolidated Income Statement of the **Pride Group** for the year ended 31st March 2011. (16 marks)
  - (b) Calculate Good will arising on acquisition of **Self-esteem** at 1<sup>st</sup> April 2010, assuming that the group policy is to value goodwill based on the proportionate value. (5 marks)
  - (c) Calculate carrying amount of the investment in **Arrogance** at 31<sup>st</sup> March 2010 under the equity method <u>prior</u> to the impairment test. (4 marks)

(Total: 25 marks)

# **Question 3**

You are presented with an opening Statement of Financial Position as at 1 April 2010 and a listing of ledger accounts as at 31 March 2011 for **Fair Trade**, a small private company.

# A. Fair trade - Statement of Financial Position as at 1 April 2010:

Assets	K'000	K'000
Non-current assets		
Land and Buildings		
(at valuation K14.76 million less accumulated		
depreciation, K1.5 million)		13,260
Plant (at cost K21 million less accumulated		
depreciation, K6.75 million)		14,250
Investments at cost		5,070
		32,580
Current Assets		
Inventory	17,220	
Trade receivables	8,580	
Bank	360	
		26,160
Total Assets		58,740
Equity and Liabilities		
Equity		
Ordinary Shares of K1 each		7,500
Share premium		1,500
Revaluation reserves		3,600
Retained Earnings Total Equity		21,090 <b>33,690</b>
Non-current Liabilities		33,090
8% Loan notes		12,960
Current Liabilities		
Trade Payables		9,420
Taxation		2,670
Total Equity and Liabilities		58,740

### B. Fair trade - Ledger accounts listing as at 31st March 2011:

	K'000	K'000
Land and Buildings at valuation	18,690	
Plant at cost	25,380	
Distribution costs		
Accumulated depreciation on 31st March 2011 - Buildi	ngs	2,040
Accumulated depreciation on 31st March 2011 - Plant		11,280
Investments at cost	2,460	
Trade receivables	15,120	
Inventory	12,990	
Bank		570
Investment income		120
Loan interest	510	
Ordinary dividend	7,830	
Ordinary Shares of K1 each		15,000
Share Premium		2,400
Retained earnings on 1st April 2010		21,090
Profit before interest and tax for year ended 31st Marc	h 2011	5,370
Revaluation reserve		5,400
8% Loan notes		11,940
Trade payables		8,010
Accrued loan interest		90
Taxation	330	
	<u>83,310</u>	<u>83,310</u>

#### Notes:

- (i) The balance on taxation account is after settlement of a provision made to ZRA for the year to 31st March 2010. A provision for the current year has not yet been made.
- (ii) Plant with a carrying amount of K3.6 million and original cost of K7.05 million was sold for K2.34 million during the year. The loss on sale has been included in the profit before interest and tax.
- (iii) The increase in the revaluation reserve was entirely due to revaluation of the company's land. No disposals of Land and buildings were made during the year.
- (iv) There were no purchases of investments during the year; but investments with a cost of K2.61 million were sold for K3.30 million in the period under review. The profit has been included in the profit before interest and tax.

(v) A bonus issue of ½ a share for 5 Ordinary shares was made on 1 October 2010, utilising the Share premium account. The remainder of the increase in Ordinary shares was due to an issue for cash on 30 October 2010.

### Required:

Prepare Fair trade's Statement of Cash flows for the year ended 31 March 2011 using the Indirect method in accordance with IAS 7: Statement of Cash flows.

(Total: 25 marks)

#### **Question 4**

(a) **Stem, Branch** and **Fruit** agreed to dissolve their partnership on 1 April 2011, after being in business for many years, sharing profits and losses in the ratio 3:2:1 respectively. Their Statement of Financial Position as at 31 March 2011 was as follows:

### Stem, Branch and Fruit

Statement of Financial	Position as at 31st	March 2011
------------------------	---------------------	------------

Assets	K'000
Non-current Assets	
Furniture and fittings	400,000
Motor vehicles	280,000
	680,000
Current Assets	
Inventory	200,000
Trade Receivables	336,000
Bank	48,000
Total Assets	1,264,000
Capital and Liabilities	
Partners' capital accounts	
Stem	360,000
Branch	240,000
Fruit	120,000
	720,000
Partners' current accounts	
Stem	78,000
Branch	59,600
Fruit	50,400
	188,000

Non-current Liabilities

Loan 144,000

**Current Liabilities** 

Trade Payables 212,000

Total capital and Liabilities 1,264,000

The following information that took place at the time of dissolution is made available:

- (1) The partners agreed to let Fruit take his personal to holder vehicle at a valuation of K72 million, in addition to his share of the profit. At the time of this agreement, the motor vehicle had a net book value of K64 million. Other motor vehicles were sold for K236 million; while inventory realised K222 million.
- (2) Furniture and fittings were sold for K390.4 million.
- (3) K319.2 million of the outstanding Trade receivables was collected.
- (4) Trade payables were paid-off and the dissolving partnership received a discount of K8.48 million upon this settlement.
- (5) The outstanding loan amount was also paid on dissolution and there were no outstanding finance costs at that time.
- (6) Dissolution expenses paid amounted to K8.0 million.

### Required:

- (a) Prepare the following accounts to record dissolution of the partnership:
  - (i) The Realisation account (10 marks)
  - (ii) Partners' account (5½ marks)
  - (ii) Cash and bank account (5½ marks)
- (b) With regard to dissolution of partnerships, discuss the ruling in *Garner v. Murray* case, highlighting the usefulness of this judgement in dissolution of partnerships. (4 marks)

(Total: 25 marks)

#### Question 5

(a) You have been presented with financial statements of two medium sized companies, Addidaz and Phuma, which are both in the same industry. You are required to calculate the following ratios for the two companies:

(i) Earnings per share (2 marks)

(ii) Gross profit percentage (2 marks)

(iii) Return on capital employed (2 marks)

(Show all workings)

# I. Income Statements for the year ended 31 March 2011

	Addidaz	Phuma
	K'000	K'000
Revenue	5,500	7,200
Cost of Sales	(4,400)	(5,040)
Gross Profit	1,100	2,160
Operating Expenses	(610)	(1,685)
Operating profit	490	475
Finance costs	(15)	(15)
Profit Before Tax	475	460
Income tax	(200)	(180)
Net Profit for the year	275	280

# II. Statements of Financial Position as at March 2011

	Addidaz	Phuma
	K'000	K'000
Assets		
Non-current assets	3,750	7,200
Current assets		
Inventory	125	360
Trade receivables	500	190
Cash	30	Nil
Total assets	4,405	7,750
Equity and liabilities		
Capital and reserves		
Ordinary shares of K1 each	3,000	7,000
Reserves	1,080	410
	4,080	7,410
Non-current liabilities		
Loan notes	75	110
Current liabilities		
Trade payables	200	205
Overdraft	nil	5
Tax	50	20
Total equity and liabilities	4,405	7,750

Profit Before Tax	475	460
Income tax	(200)	(180)
Net Profit for the year	275	280

- (b) Arising from the ratios calculated above, comment on the performance of the two companies as indicated by each of the ratios in (i) to (iii). (9 marks)
- (c) Briefly describe five (5) limitations of using ratios as a basis for analysing business performance. (5 marks)
- (d) Explain how the following accounting terms are useful in enhancing the value of financial statements to users:

(i)	Going concern concept	(1 mark)
(ii)	Accruals Concept	(1 mark)
(iii)	Reliability	(1 mark)
(iv)	Understandability	(1 mark)
(v)	Comparability	(1 mark)

(Total: 25 Marks)

#### **Question 6**

- (a) Agriculture in Zambia is one of the major economic activities. In order to regulate accounting practice in this sector, the IASB introduced IAS 41: Agriculture, which prescribes accounting treatment of agricultural activities when preparing financial statements.
  - (i) What are the recognition criteria for biological assets under IAS 41: Agriculture?(6 marks)
  - (ii) Explain the measurement basis for biological assets recommended by IAS 41: *Agriculture*. (4 marks)
- (b) IAS 10: Events After the Reporting Period, gives guidance on accounting treatment of events covered under this standard. Define:
  - (i) An adjusting event;

(2 marks)

(ii) A non-adjusting event after the reporting period; and

(2 marks)

- (iii) State the accounting treatment for an adjusting event and non-adjusting event.(2 marks)
- (c) Kings Trade Limited is a large manufacturing company in Zambia. Between the reporting date and the date financial statements were to be authorised for issue, the following material events occurred:
  - It was discovered that a receivables balance existing at the reporting date will not now be received.
  - Kings Trade has announced a bid to take over another company, Maheu Limited.
  - Some material errors have been discovered which show that financial statements for the period under review are incorrect.
  - The trade union has announced to management that the factory workforce at Kings Trade has started strike action for an indefinite period of time.

## Required:

For each of the four (4) events described above, state if they should be treated as an adjusting or non-adjusting event after the reporting period for Kings Trade. (4 marks)

(d) Generally comment on how useful the accounting framework is in the preparation of financial statements. Your answer should have particular reference to both the conceptual and regulatory framework of accounting. (5 marks)

(Total: 25 marks)

#### **END OF PAPER**

# JUNE 2011 L2: FINANCIAL REPORTING SUGGESTED SOLUTIONS

# (a) (i) Chachacha Ltd

# Statement of Comprehensive Income for the Year Ended 31st March 2011

	K'000
Revenue	304,000
Cost of Sales (w1)	(227,740)
Gross Profit	76,260
Administration Expenses [K40.4m - ((K50m $\div$ K20) $\times$ K2)]	(35,400)
Distribution Expenses	(13,920)
Investment income	1,040
Profit on sale of Available-for-sale investments (w2)	3,200
Finance costs (18% × K16m)	(2,880)
Profit Before Tax	28,300
Taxation [K12.96m + (K7.44 – 4.32)]	(16,080)
Profit After Tax	12,220
Other Comprehensive income:	
Gain on Available-for-sale investments (w3)	2,000
Realised profit charged to income on Available-for-sale investment	(1,440)
Gain on revaluation of Machinery	48,000
Total Other Comprehensive income	48,560
Total Comprehensive income	60,780

(ii) Chachacha Ltd

Statement of Changes in Equity for Year Ended 31st March 2011

	Share	Other	Retained	
	Capital	Reserves	<b>Earnings</b>	Total
	K'000	K'000	K'000	K'000
Balance @ 1 April 2010	50,000	4,000	32,848	86,848
Realised gain on AFSI	nil	(1,440)	nil	(1,440)
Gain on AFSI during the year	nil	2,000	nil	2,000
Revaluation of Machinery	nil	48,000	nil	48,000
Profit for the Year	nil	nil	12,220	12,220
Dividends paid	nil	nil	(5,000)	(5,000)
Balance @ 31 March 2011	50,000	52,560	40,068	142,628

# (b) Chachacha Ltd

# Statement of Financial Position as at 31st March 2011

Assets	K'000
Non-current Assets	
Property, Plant and Equipment (W4)	131,000
Available-for-sale investments	23,200
	154,200
Current Assets	
Inventory [K22.4m - K3.3m (W5)]	19,100
Trade Receivables	34,394
Cash and Cash Equivalents	4,614
Total Assets	212,308
Equity and Liabilities	
Equity	
Ordinary Shares of K2 each	50,000
Other reserves	52,560
Retained Earnings	40,068
Total Equity	142,628

	Non-current Liabilities	
	12% Loan notes (W6)	18,960
	Deferred tax (K4.32m + K3.12m)	7,440
	Current Liabilities	
	Trade Payables	30,320
	Current Tax	12,960
	Total Equity and Liabilities	212,308
WO	RKINGS	
1.	Cost of Sales	K'000
	Per Question	197,440
	Depreciation	
	<ul> <li>Buildings (K6.4m ÷ 8 years)</li> </ul>	800
	- Plant & Equipment [ $40\% \times (K33.76m - K15.76m)$ ]	7,200
	<ul><li>Machinery (w5)</li></ul>	19,000
	Loss on inventory [(K9.7m $-$ K4.6m) $-$ K8.4m]	3,300
		227,740
2.	Profit on Sale of Available-for-sale investment	K'000
	Gain in current year (K8.8m proceeds less K7.04m CA)	1,760
	Reclassified past revaluation gains from other reserves:	
	(K7.04m, CA less K5.6m, Original cost)	1,440
		3,200
	Remaining investments have a fair value of K23.2 million at 31 March 201 increase of K2 million (credited to Other reserves, w3)	11, giving a fair value
3.	Other reserves (AFSI)	K'000
	Per question	4,000
	Reclassified gain (w2)	(1,440)
	Increase during the year (w2)	2,000
	Carrying amount	4,560

## 4. Non-current Assets

		Freehold Property K'000	Plant & Equipment K'000	Machinery K'000	Total K'000
	Cost/Valuation				
	Balance @ 1 Apr 2010	50,400	33,760	80,000	164,160
	Revaluation (W5)			48,000	48,000
	Balance @ 31 Mar 2011	50,400	33,760	128,000	212,160
	Depreciation				
	Balance @ 1 Apr 2010	6,400	15,760	32,000	54,160
	Charge for the year (w1 & w5)	800	7,200	19,000	27,000
	Balance @ 31 Mar 2011	7,200	22,960	51,000	81,160
	NBV at 1 Apr 2010	44,000	18,000	•	110,000
	NBV at 31 Mar 2011	43,200	10,800	77,000	131,000
5.	Machinery revaluation				K'000
	At 1 April 2010				80,000
	Accumulated Depreciation				(32,000)
	Depreciation, i.e. from 1.04.10 - 1.	10.10; [(K80m	÷ 5) × ½]		(8,000)
	Depreciation, i.e. from 1.10.10 - 31	I.03.11; [(K88r	n ÷ 4) × ½]		(11,000)
	Revaluation - bal. figure				48,000
	At 31 March 2011 (NBV)				77,000
6.	12% Loan note redeemable 2014	ļ			K'000
	Per question (Trial balance)				18,000
	Add 18% Effective interest on nom	ninal value			2,880
	Less amount paid in trial balance				(1,920)
	Carrying value at 31 March 2011				18,960

# (a) Pride Group

# Consolidated Income Statement for the Year Ended 31 March 2011

	K'000
Revenue (84,000 + 49,600 - 14,400 intra group)	119,200
Cost of Sales (see working)	(71,200)
Gross Profit	48,000
Distribution costs (3,200 + 1,600)	(4,800)
Administration Expenses (6,000 +5,600)	(11,600)
Finance costs (960 + 720)	(1,680)
Impairment losses:	
Goodwill [20% $\times$ 20,224 - see part (b)]	(4,045)
Investment in associate (14,720 - 14,000)	(720)
Share of loss from associate (16,000 $\times$ 40% $\times$ 3/12)	(1,600)
Profit before Tax	23,555
Taxation (6,960 + 2,080)	(9,040)
Profit for the period	14,515
Attributable to:	
Equity holders of the parent	12,595
Non-controlling interests $\{(10,400 - 800 \text{ additional depreciation}) \times 20\%\}$	1,920
	14,515
Note: Dividend in Self-esteem is eliminated on consolidation.	
Cost of sales working:	
	K'000
Pride per question	54,400
Self-esteem per question	29,200
Intra group purchases	(14,400)
Additional depreciation on plant (4,000 ÷ 5 years)	800
Unrealized profits in inventories [6,000 $\times$ (25% $\div$ 125%)]	1,200
	71,200

# (b) Goodwill

		K'000	K'000
	Consideration transferred:		
	Share exchange (12,800 $\times$ 80% $\times$ 3/5 $\times$ K4)		30,720
	Deferred consideration (12,800 $\times$ K2 $\times$ 0.840)		21,504
			52,224
	Less		
	Equity shares	16,000	
	Pre acquisition reserves	14,400	
	Fair value adjustments (3,200 + 2,400 + 4,000)	9,600	
		$40,\!000\times80\%$	(32,000)
(c)	Carrying amount of Arrogance before impairment		20,224
	At cost:		K'000
	Cash (4,800 × K2.4)		11,520
	15% Loan note [4,800 × (K100 ÷ 100)]		4,800
			16,320
	Less Post acquisition losses (16,000 $\times$ 40% $\times$ 3/12)		(1,600)
			<u>14,720</u>

Solution 3

Fair trade

Statement of Cash Flows for Year Ended 31 March 2011

	K'000	K'000
Cash Flows from Operating Activities		
Net Profit Before interest and Taxation		5,370
Depreciation (wi) [540 + 7,980]		8,520
Loss on sale of plant (3,600 – 2,340)		1,260
Profit on sale of investments (3,300 – 2610)		(690)
Decrease in Inventory (17,220 – 12,990)		4,230
Increase in Receivables (15,120 – 8,580)		(6,540)
Decrease in Payables (9,420 - 8,010)		(1,410)
Cash Generated from Operations		10,740
Interest paid (510 – 90)		(420)
Taxation paid (2,670 + 330)		_(3,000)
Net Cash Flow from Operating Activities		7,320
Cash Flows from Investing Activities		
Purchase of Plant (wi)	(11,430)	
Purchase of Land and buildings	(2,130)	
Investments income	120	
Sale of plant (wi)	2,340	
Sale of investments	3,300	
Net Cash used in Investing Activities		(7,800)
Cash Flows from Financing Activities		
Proceeds from Share Issue	8,400	
Redemption of 8% loan notes (12,960 - 11,940)	(1,020)	
Ordinary dividend paid	(7,830)	
Net Cash used in Financing Activities		(450)
Net Decrease in Cash and Cash Equivalents		(930)
Cash and Cash Equivalents at Start		360_
Cash and Cash Equivalents at End		(570)

# Workings

(ii)

# (i) Non-current assets

# Land and buildings:

_	
Valuation b/f	14,760
Revaluation surplus (5,400 - 3,600)	1,800
Acquisitions - balancing figure	2,130
Valuation c/f	18,690
Depreciation b/f	1,500
Charge for the year - bal. Figure	540
Depreciation c/f	2,040
Plant:	
Cost b/f	21,000
Disposals at cost	(7,050)
Acquisitions - bal. figure	11,430
Cost c/f	25,380
Depreciation b/f	6,750
Disposals	(3,450)
Charge for the year - bal. Figure	7,980
Depreciation c/f	11,280
Disposal of plant:	
Net book value	3,600
Proceeds from question	(2,340)
Loss on sale	1,260
Share capital and share premium:	
Ordinary shares b/f	7,500
Bonus issue of ½ for 5 (from premium)	750
Ordinary shares c/f	(15,000)
Share issue for cash - difference	(6,750)

	Share premium:	
	Share premium b/f	1,500
	Bonus issue	(750)
	Share premium c/f	(2,400)
		1,650
	Total proceeds of issue (6,750 + 1,650)	8,400
(iii)	Reconciliation of revaluation reserve	
	Balance b/f	3,600
	Revaluation of land - difference	1,800
	Balance c/f	5,400

# (a) (i) REALISATION ACCOUNT

()				
	K'000		K'000	
Furniture	400 000	Loan account	144,000	
Motor vehicles	280,000	Trade Payables	212,000	
Inventory	200,000	Cash and bank:		
Trade Receivables	336,000	Furniture and fittings	390,400	
Cash and bank:		Motor vehicles	236,000	
Loan	144,000	Inventory	222,000	
Trade payables	203,520	Receivables	319,200	
Dissolution expenses	8,000	Fruit	72,000	
Share of profit on Realisa	ation:			
Stem 3/6	12,040			
Branch 2/6	8,024			
Fruit 1/6	4,016			
	1,595,600		1,595,600	
		I		

# (ii) PARTNERS' CURRENT AND CAPITAL ACCOUNTS

	Stem	Branch	Fruit		Stem	Branch	Fruit
Vehicle taken	K'000	K'000	K'000		K'000	K'000	K'000
over	nil	nil	72,000	Capital a/cs	360,000	240,000	120,000
Cash to settle	450,040	307,624	102,416	Current a/cs Realisation	78,000	59,600	50,400
				A/c (profit)	12,040	8,024	4,016
	450,040	307,624	174,416	ν,	450,040	307,624	174,416

## (iii) CASH AND BANK ACCOUNT

	K'000	K'000	
Balance b/d	48,000	Realisation a/c:	
Realisation a/c		Loan	144,000
Furniture and fittings	390,400	Payables	203,520
Motor vehicles	236,000	Dissolution expenses	8000
Inventory	222,000	Partners' a/cs:	
Receivables	319,200	Stem	450,040
		Branch	307,624
		Fruit	102,416
_	1,215,600		1,215,600

(b) The rule in Garner v. Murray (1904) states that where a partner becomes insolvent or bankrupt at dissolution, the solvent partner(s) should bear the insolvent partner's debts to the partnership pro rata to capital amounts. This works out in such a way that the amount due from insolvent partner, plus balance in cash account should exactly equal the amount due to solvent partner(s) to clear the outstanding balance on closing capital account(s). (2 marks)

The presiding judge's decision in this case was based on the doctrine of equity so that the insolvent partner gets relief from former partners, given his crisis. This rule helps solve the insolvent partner's liability to the dissolving firm because he has no resources to meet this obligation. (2 marks)

(Total 4 marks)

(a)

Ratio	Formulae	Addidaz	Phuma
EPS	$\frac{\text{Net Profit after tax}}{\text{No. of ordinary shares}} \times 100$	$\frac{275}{3,000}$ = 9.2 ngwee	$\frac{280}{7,000}$ = 4.0 ngwee
Gross profit %	$\frac{\text{Gross Profit}}{\text{Sales}} \times 100$	$\frac{1,100}{5,500} \times 100 = 20.0\%$	$\frac{2,160}{7,200} \times 100 = 30.0\%$
ROCE	$\frac{\text{Profit before int. & tax}}{\text{Capital employed}} \times 100$	$\frac{490}{4,155} \times 100 = 11.8\%$	$\frac{475}{7,520} \times 100 = 6.3\%$

(b)

Ratio	Addidaz	Phuma	Comment
Earnings per Share	9.2 ngwee	4.0 ngwee	Addidaz has a higher EPS than Phuma, and from the shareholder's perspective, Addidaz would be considered a better investment of the two. However, it would be useful to have EPS figures for the previous year so that any trends could be identified.
Gross profit percentage	20.0%	30.0%	Phuma achieved a significantly higher gross profit percentage than Addidaz. A number of factors could be attributed to this, e.g. Phuma may be operating a superior brand to Addidaz's and consequently is able to charge a premium price to its customers. Phuma may also be cost effective in its production costs. On the other hand, Addidaz may be incurring high production costs resulting in higher selling prices.
Return on Capital	11.8%	6.3%	Addidaz's ROCE is nearly double that of Phuma. This could be that the former company

Employed	is better managed than the latter. Without
	doubt, Addidaz's return still represents a
	reasonable return looking at the current
	borrowing rates. However, more information
	such as correct valuation of both companies'
	assets may give more information on the two
	companies.
	·

### (c) Limitations of accounting ratios:

- 1. No two companies are exactly the same, hence company performance analysis based purely on accounting ratios may not be very useful.
- 2. Changes in accounting policies from year to year may produce misleading results and ratios.
- 3. Price changes from year to year may make comparisons difficult.
- 4. Accounting information used to prepare ratios is often historic, making ratios out dated.
- 5. Accounting information in form of published accounts is often summarised, making detailed analysis difficult.
- 6. Different use of accounting policies may make direct comparison of companies difficult.

#### (d) Usefulness of accounting concepts:

- (i) Going concern concept implies that the business will continue in operational existence for the foreseeable future, and that there is no intention to put the company into liquidation or make drastic cutbacks on the scale of operation.
  - This concept largely influences the assumptions made when evaluating particular statement of financial position items, e.g. assets are normally shown at net realisable value because they are expected to be kept in the business for future use.
- (ii) The **accruals concept** requires that revenue and costs are recognised as they are earned or incurred, rather than when money is received or paid.
- This enables performance analysis possible because a firm's revenue and costs are matched with each other.
- (iii) Accounting information must be reliable if it is to be useful. For accounting purposes, this means that information should be free from material error and bias so that the user is able to adduce faithful representation.

- (iv) Understandability of accounting information simply means that users must be able to understand it. This means that accounting information should be simplified so as to portray meaning even to non-accounting professionals.
- (v) **Comparability** of accounting information both in terms of time and with other entities is of vital importance. This is why use of accounting ratios would be very beneficial if the underlying information in them is comparable in order to make informed decisions.

- (a) (1) IAS 41: Agriculture states that animals and plants should be recognised as assets in the following circumstances:
  - (i) where the entity controls the asset as a result of past events. This could be evidenced by formal ownership records such as title deeds, branding, etc.
  - (ii) it must be probable that the flow of economic benefits associated with the asset will flow to the entity.
  - (iii) the cost or fair value of the asset to the entity can be measured reliably. Reliable measurement can be through measures used by the markets.

(2 marks each for correct explanation of recognition criteria, maximum 6 marks)

(2) IAS 41: Agriculture requires that each year end, all biological assets should be measured at fair value less estimated point of sale costs. The standard assumes that fair value, compared with historic cost gives greater relevance, reliability, comparability and understanding as a measure of future economic benefits.

IAS 41 however allows an alternative valuation method on initial recognition where fair value can not be determined and market determined prices or values are not available.

(2 marks each for correct benchmark and allowed alternative method, maximum 4 marks)

- (b) (i) Adjusting events: These are events that provide evidence of a condition that existed at the reporting date.
  - (ii) Non-adjusting events: These are events that are indicative of conditions that arose after the reporting date.
  - (iii) Accounting treatment

IAS 10 requires that the amounts recognised in the financial statements be adjusted to take account of an adjusting event.

The standard also requires that disclosures be up-dated in the light of new information that relate to a condition that existed at the reporting date.

IAS 10 prohibits the adjustment of amounts recognised in the financial statements to reflect non-adjusting events after the reporting date. However, if a non-adjusting event is material and its non-disclosure could influence the decisions of users, then an entity should disclose the following:

- (a) the nature of the event
- (b) an estimate of its financial effect, or a statement that such an estimate cannot be

Up to 3 marks for defining each type of event and how they should be treated (maximum 6 marks).

### **Kings Trade Limited**

- (c) (i) Receivables that were thought to be good at the Statement of Financial Position date will not now be paid. This is an Adjusting event.
  - (ii) Kings trade has announced a bid to take over Maheu Ltd. This is a non adjusting event.
  - (iii) Some material errors have been discovered which show the financial statements are incorrect. This is an Adjusting event.
  - (iv) The factory workforce at Kings trade has started strike action for an indefinite length of time. This event is non adjusting.
    - Marking scheme: 1 mark for each correct answer (maximum 4 marks)
- (d) The accounting framework forms an important basis for accounting in that through it, practicing and reporting accountants are able to prepare financial statements and interpret economic events in the most objective manner. This enhances the value of financial statements to varying users.

The conceptual framework refers to the generally accepted theoretical principles which form the structure for financial reporting. Without this framework, there could be a haphazard way of preparing financial reports.

The conceptual framework therefore tends to standardise accounting practice and theory.

The regulatory framework is the most important element in ensuring that relevant and reliable financial reporting is done, and hence meeting the needs of users.

Accounting standards, for instance have helped achieve uniformity in accounts preparation and reporting.

1 mark for general comment and 2 marks each for correct specific answer (maximum 5 marks)

**END**