

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA(U) EXAMINATIONS

### LEVEL FOUR

#### FINANCIAL REPORTING - PAPER 16

**WEDNESDAY, 19 JUNE 2002**

#### INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Section **A** has **one** compulsory question carrying 60 marks.
3. Section **B** has **three** questions and only **two** questions are to be attempted. Each question carries 20 marks.
4. Please, read further instructions on the answer book.

## SECTION A

### Question 1.

The summarized draft consolidated financial statements of A Ltd to 31 March 2002 are shown below:

A Ltd  
Income Statement for the year ended 31 March, 2002.

	Shs. million
Sales revenue	50,000
Cost of Sales	<u>(30,000)</u>
Gross profit	20,000
Operating costs	<u>(4,000)</u>
Profit from operations	16,000
Finance costs	<u>(1,000)</u>
Profit before tax	15,000
Income tax expense	<u>(5,000)</u>
Profit after tax	10,000
Minority interests	<u>(1,500)</u>
Net profit from ordinary activities	8,500
Extraordinary item	<u>(20)</u>
Net profit for the period	<u><u>8,480</u></u>

**Balance Sheet as at 31 March 2002**

Shs million

**Assets**

Non-current assets:

Property, plant and equipment	25,000
Goodwill	300
Other intangibles – Data base	<u>200</u>
	25,500

Current assets 14,850Total assets 40,350**Equity and Liabilities**

Capital and reserves:

Equity share of Shs 1,000 each	4,000
Accumulated profits	<u>14,000</u>
	18,000

Minority interest 9,500  
27,500

Non-current liabilities:

6% convertible loan stock 5,000

Current liabilities 7,850Total equity and liabilities 40,350

The group accountant has asked for your advice on several matters.

These issues are set out below:

- 1 (a) Certain items of machines appeared to have suffered a permanent diminution in value. The historical cost carrying value of the machines is Shs 1,000 million and its net selling price is estimated at Shs 800 million. The anticipated net cash inflows from the machines is now Shs 350 million per annum for the next three years. A market discount rate of 10% per annum is to be used in any present value computations.
- (b) A Ltd acquired a business **X** on 1 January 2002 for Shs. 2,000 million. The values of the assets of the business at that date based on net selling price were as follows:

Shs million

Property, plant and equipment	1,500
Intangible assets – Database (with an active market)	<u>200</u>
	<u>1700</u>

On 31 March 2002 a rival company of **X** commenced business in the same area. It is anticipated that business revenue of **X** will be reduced

considerably leading to a decline in the present value in use of the business which is calculated at Shs. 1,600 million. The net selling value of database has fallen to Shs. 150 million as a result of the rivalry. The net selling value of property, plant and equipment has remained the same as at 1 January 2002 throughout the period. **Goodwill paid for this transaction remains at cost in the draft Balance Sheet.**

- 2 (a) A Ltd purchased 100% of Y during the year. As part of the sale agreement, goods have to be supplied to Y's former holding company at an uneconomic rate for a period of ten years. As a result A Ltd will incur operating losses of Shs. 1,000 million (discounted) over next 10 years. No goodwill arose on acquisition of Y on the basis that the above losses were not provided for on acquisition. A Ltd amortises goodwill over 5 years with full year's amortisation in the year of acquisition.
- (b) A Ltd has a leasehold property (depreciated historical cost Shs. 300 million at 31 March 2002). The property has been converted into a canteen for the employees. Under the terms of the lease, the property must be restored to its original state when the lease expires in ten years' time. The present value of the costs of reinstatement are likely to be Shs. 500 million. The lease is for 10 years and was signed and operated from 1 April, 2001.
3. On 1 April 2001 A Ltd issued Shs. 5,000 million 6% convertible loan stock at par. The stock is convertible into equity shares, or redeemable at par, on 31 March 2006, at the option of the stockholders. The terms of conversion are that each Shs. 10,000/= loan stock will be convertible into 5 equity shares of A Ltd. Current market interest rate is 10%.
4. On 31 March 2002 the Board of A Ltd approved a resolution to close the whole of its loss – making supermarket operation. A formal plan was in place and the decision was communicated on 31 March 2002 to all the parties affected by the closure. The results of supermarket operation up to 31 March 2002 (included in the above financial statements) were as follows:

	Shs. million
Revenue	5,000
Cost of Sales	<u>(6,000)</u>
Gross loss	(1,000)
Operating costs	<u>(1,500)</u>
Operating loss	<u>(2,500)</u>

The assets and liabilities at carrying value on 31 March 2002 (included in the above financial statements) were:

	Shs. million
Assets	7,000
Liabilities	<u>(4,000)</u>
Net assets	<u>3,000</u>

A binding agreement to dispose the assets for Shs. 2,500 million was signed on 31 May, 2002.

The costs of closure are estimated at:

	Shs million
Redundancy	200
Penalty costs for non-performance	150
Professional costs	50

Operating losses for the period 1 April 2002 to the date of sale are estimated at Shs. 100 million.

5. A lease rental of Shs. 200 million was paid on 1 April 2001 and is included in the Income Statement as part of the operating costs. It is the first of five annual payments in advance for an item of machinery that has a cash price of Shs 800 million. The implicit interest rate in the lease is 12% per annum. A Ltd depreciates leased assets on a straight – line basis over the life of the lease.
6. The outstanding account receivable of a major customer amounting to Shs. 1,000 million was factored to Crane Finance on 1 March 2002. The terms of the factoring were:
  - Crane Finance paid 80% of the outstanding account to A Ltd immediately.
  - Crane Finance will pay the balance (less the charges) when the account is collected in full.
  - Crane Finance will transfer any amount of the account outstanding after three months to A Ltd at its full book value.
  - Crane Finance will charge 1% per month of the net amount owing from A Ltd at the beginning of each month.

Crane Finance had not collected any of the amounts receivable by 31 March 2002.

A Ltd has credited the receivable with the cash received from Crane Finance and the difference between the receivable and cash

received has been included as part of the operating costs in the Income Statement.

7. Current liabilities include a balance of shs 250 million in relation to a three-year construction contract entered into by A Ltd on 1 April, 2001.

	Shs million
Construction contract costs to 31 March 2002 (including costs of Shs 100 million for remedial work)	750
Construction contract progress billing, received	<u>(1,000)</u>
Included in current liabilities	<u>(250)</u>
Contract Price	2,000
Estimated total contract costs (excluding costs of remedial work)	1,500
Agreed value of work completed on 31 March 2002	1,200

The percentage of completion is deemed to be the agreed value of the work completed to date as a percentage of the total contract price.

8. The extraordinary item represents the cost (Shs. 30 million less tax relief of Shs 9 million minority interests share of Shs 1 million) by a subsidiary of A Ltd incurred during the year of making the company's factory building "noise – proof". As this cost is not likely to recur it has been treated as an extraordinary item.

**Required:**

- (a) **Discuss** how the above issues should be dealt with in the group financial statements of A Ltd, stating the nature of the accounting entries required.
- (b) Prepare revised consolidated financial statements of A Ltd taking into account the above issues.

**(50 marks)**

**(10 marks)**

**(Total 60 marks)**

**Question 2**

Henry, a listed company, entered into an expansion programme on 1 April 2001. On that date Henry acquired investments in two listed companies, Steven and Arthur. The details of the acquisitions are as follows:

	Cost of Investment  Shs million	Number of shares acquired	Accumulated profits on the date of acquisition Shs million
Investment in Steven	1,500	600,000	700
Investment in Arthur	610	240,000	425

The Balance Sheets of the three companies at 31 March 2002 are shown below:

	<b>HENRY</b> Shs million	<b>STEVEN</b> Shs million	<b>ARTHUR</b> Shs million
<b>Assets</b>			
Non-current assets:			
Property plant and equipment	3,640	2,000	1,100
Investments			
- In Steven	1,500		
- in Arthur	<u>610</u>		
	<u>5,750</u>		
Current Assets:			
Inventories	1,000	400	250
Trade receivables	2,000	720	300
Bank	<u>-</u>	<u>80</u>	<u>150</u>
	<u>3,000</u>	<u>1,200</u>	<u>700</u>
Total assets	<u><b>8,750</b></u>	<u><b>3,200</b></u>	<u><b>1,800</b></u>

	<b>HENRY</b> Shs million	<b>STEVEN</b> Shs million	<b>ARTHUR</b> Shs million
<b>Equity &amp; Liabilities</b>			
Capital and reserves:			
Equity share of Shs. 1,000 each	1,000	800	600
Reserves:			
Share premium	500	200	200
Accumulated profits	<u>4,500</u>	<u>800</u>	<u>600</u>
	6,000	1,800	1,400
Non-current liabilities:			
8% Debentures	-	500	-
Current liabilities:			
Trade payables	1,500	400	300
Taxation	1,000	500	100
Overdraft	<u>250</u>	<u>-</u>	<u>-</u>
	2,750	900	400
Total equity and liabilities	<b><u>8,750</u></b>	<b><u>3,200</u></b>	<b><u>1,800</u></b>

The following information is relevant:

- (i) At the date of its acquisition the fair values of Steven's net assets were equal to their book values with the exception of Land and Buildings that had a fair value of Shs. 140 million in excess of its book value. (Land Shs. 40 million and buildings Shs. 100 million). Henry depreciates buildings at 4% per annum on a straight-line basis. The fair value adjustment is not incorporated in Steven's accounts. The group adopts the **benchmark treatment** contained in IAS 22 'Business Combinations' for the fair value of assets acquired and minority interests.
- (ii) Henry exercises significant influence over operating and financial policies of Arthur. At the date of acquisition the fair values of Arthur's net assets were equal to their book values. The group adopts, the equity method for investment in associates.
- (iii) During the year Steven sold goods to Henry at a selling price of Shs. 120 million which gave Steven a profit of 25% on cost. Henry had half of these goods in inventory at 31 March 2002.
- (iv) On 31 March 2002 Steven remitted to Henry a cash payment of Shs. 20 million to completely clear its outstanding current account balance with Henry. This was not received by Henry until early April.



- (v) The group accounting policy for goodwill is to write it off on a straight – line basis over a period of 4 years.

**Required:**

Prepare the consolidated balance sheet of Henry as at 31 March 2002.

**(20 marks)**

**Question 3**

The following information relates to Enterprise Group for the year to 31 March 2002.

Consolidated Income Statement for the year ended 31 March, 2002.

	Shs million
Profit before taxation	2,000
Income Tax expense	<u>(600)</u>
Profit after taxation	1,400
Minority Shareholders' interests	<u>(200)</u>
Net profit for the year	<u>1,200</u>

## Consolidated Balance Sheet

	<b>2002</b> Shs million	<b>2001</b> Shs million
<b>Assets</b>		
Non-current assets:		
Tangible	8,280	6,470
Goodwill	<u>240</u>	<u>-</u>
	<u>8,520</u>	<u>6,470</u>
Current assets:		
Inventories	2,000	1,000
Receivables	<u>3,500</u>	<u>2,000</u>
	<u>5,500</u>	<u>3,000</u>
<b>Total assets</b>	<b><u>14,020</u></b>	<b><u>9,470</u></b>
<b>Equity and Liabilities</b>		
Share Capital		
Equity shares of Shs 1,000 each	5,000	4,000
Reserves		
Share premium	700	
Accumulated profits	<u>4,900</u>	<u>3,800</u>
	10,600	7,800
Minority shareholder's interest	650	<u>-</u>
Non-current liabilities:		
Obligations under finance lease	<u>300</u>	<u>100</u>
	<u>11,550</u>	<u>7,900</u>
Current liabilities:		
Payables	1,450	1,000
Obligations under finance lease	70	50
Taxation	600	400
Bank overdraft	<u>350</u>	<u>120</u>
	<u>2,470</u>	<u>1,570</u>
<b>Total equity and liabilities</b>	<b><u>14,020</u></b>	<b><u>9,470</u></b>

Additional information:

1. Depreciation charged in the consolidated income statement for the period totalled Shs 1,010 million. There were no disposals of non-current assets in the period.
2. Interest paid during the year amounted to Shs 40 million. Accrued interest payable at the beginning of the year and at the end of the year was Shs. 8 million and Shs 12 million respectively.
3. Dividends paid in the year amounted to Shs. 100 million.
4. On 1 April 2001 Enterprise Group acquired 75% of the equity share capital of Starhope Ltd. The acquisition made Starhope a subsidiary of Enterprise Group. The net assets of Starhope at fair values on 1 April 2001 were as follows:

	Shs million
Tangible non-current assets	1,500
Inventories	500
Receivables	500
Payables	(400)
Taxation	(50)
Bank Overdraft	<u>(50)</u>
	<u>2,000</u>

The purchase consideration was settled by Enterprise Group as follows:-

	Shs. millions
Issue of 1 million Shs 1,000 equity shares at a price of Shs. 1,700 per share.	1,700
Payment of cash	<u>100</u>
	<u>1,800</u>

Enterprise uses the **allowed alternative** treatment contained in IAS 22: Business Combinations for the fair value of assets acquired and minority interests. Enterprise Group amortises goodwill arising on consolidation over 5 years.

5. Tangible non-current assets on 31 March 2002 include certain items of machines which were acquired using finance leases. The fair value of these machines on the date of acquisition was Shs 320 million.

**Required:**

Prepare a group cash flow statement for Enterprise Group for the year ended 31 March 2002 in accordance with IAS 7: Cash Flow Statements.

**(20 marks)**

**Question 4**

Mukasa, a public limited company, acquired 80% of the ordinary share capital of Chang on 1 April 2000. Chang is a public limited company and is situated in a foreign country and the local currency in the foreign country is MR. Mukasa paid Shs 3,500 million for its 80% holding in Chang when the retained profits of Chang were MR 10 million. Chang will operate as a separate entity and Mukasa intends to use the allowed alternative treatment in IAS 22 'Business Combinations' for the fair value of assets acquired and minority interests. Chang has not issued any share capital, nor revalued any assets since acquisition.

The following financial statements relate to Mukasa and Chang:

## Balance Sheets at 31 March 2002

	Mukasa Shs million	Chang MR million
Non-current assets		
Tangible assets	5,000	30
Investment in Chang	3,500	-
Net current assets	<u>2,500</u>	<u>20</u>
	<u>11,000</u>	<u>50</u>
Capital and reserves		
Ordinary share of Shs 1,000/ 1 MR	2,000	10
Share premium	1,000	10
Accumulated profits	<u>6,000</u>	<u>25</u>
	9,000	45
Non-current liabilities	<u>2,000</u>	<u>5</u>
	<u>11,000</u>	<u>50</u>

## Income Statement for the year ended 31 March 2002

	Shs million	MR million
Revenue	28,000	90
Cost of sales	<u>(14,000)</u>	<u>(45)</u>
Gross profit	14,000	45
Operating costs	<u>(8,500)</u>	<u>(21)</u>
Profit from operations	5,500	24
Interest payable	<u>(500)</u>	<u>(3)</u>
Profit before taxation	5,000	21
Income tax expense	<u>(1,500)</u>	<u>(6)</u>
Net profit for period	<u>3,500</u>	<u>15</u>

Additional information:

- (i) The fair value of the net assets of Chang at the date of acquisition was MR 40 million. The directors have estimated that any goodwill arising on consolidation should be amortised over four years. The increase in the fair value of Chang over the net assets carrying value relates to land (included in tangible non-current assets) owned by Chang. The value of land (in MR) has not changed materially since acquisition. Goodwill is to be treated as a Uganda shilling asset which does not fluctuate with changes in the exchange rate.
- (ii) There were no inter company transactions in the year.
- (iii) The following exchange rates are relevant to the financial statements:

MR to Shs 1,000:

1 April 2000	10
31 March 2002	20
Weighted average for year to 31 March 2002	15

- (iv) A dividend of Shs 1,000 million had been paid by Mukasa during the financial year.

**Required:**

Prepare a consolidated income statement for the year ended 31 March 2002 and a balance sheet as at that date. Candidates should show any exchange gains or losses arising in the consolidated statements.

**(20 marks)**