TECHNICAL UNIVERSITY OF MOMBASA

SCHOOL OF BUSINESS

Department of Accounting & Finance

UNIVERSITY EXAMINATION FOR:

BACHELOR OF COMMERCE
BACHELOR OF BUSINESS ADMINISTRATION

BAC 4401: ADVANCED ACCOUNTING II

END OF SEMESTER EXAMINATION

SERIES: DECEMBER 2016

TIME: 2 HOURS

DATE: 2016

Instructions to Candidates
You should have the following for this examination
-*Answer Booklet, examination pass and student ID*
This paper consists of FIVE questions. Question One is Compulsory. Answer any other two questions.
Do not write on the question paper.

Question ONE (Compulsory)

The draft summarized statements of financial position of Highland Ltd and Lowland Ltd at 31 December 20X2 are set out below. On 31 March 20X2 Highland Ltd acquired for cash 75% of the sh.1.00 ordinary shares in lowland Ltd. The retained earnings of the two companies at 1 January 20X2 were sh.2.8 million and sh.1.5 million respectively.

		Highland Ltd		**Lowland Ltd**
ASSETS	**Sh.000**	**Sh.000**	**Sh.000**	**Sh.000**
Non-current assets:				
Property, plant and equipment		3,560		2,800
Investments in Lowland		2,940		-
		6,500		2,800
Current assets:				
Inventories	1,150		550	
Trade receivable - group	400		-	
Trade receivables – other	1,500		800	
Cash and cash equivalents	100		50	
		3,150		1,400

Total assets		9,650		4,200
EQUITY AND LIABILITIES				
Equity				
Ordinary Share Capital		3,500		900
Share premium account		700		170
Retained earnings		3,500		2,300
		7,700		3,370
Non-current liabilities:				
Borrowings		1,100		110
Current liabilities:				
Trade payables – group	-		400	
Trade payables – other	850	850	320	720
Total equity and liabilities		9,650		4,200

Additional information:

(1) The fair value of Lowland Ltd's property on 31 March 20X2 was sh.200,000 above its carrying amount. All of this relates to the buildings element of the property, which is being depreciated at 4% per annum.

(2) At the date of acquisition the replacement cost of raw material inventories was sh.400,000. The carrying amount was sh.300,000. At 31 December 20X2 30% of these raw materials remained in inventory. The rest had been converted to finished goods and sold to third parties.

(3) Since the date of acquisition Highland Ltd has sold to Lowland Ltd inventories valued at sh.800,000; half of these goods remained in the inventories of Lowland Ltd at 31 December 20X2. Highland Ltd calculated the transfer price of the goods at cost plus a mark-up of 25%.

(4) It is the accounting policy of Highland Ltd to undertake annual reviews for goodwill impairment. At 31 December 20X2 an impairment of sh.20,000 was identified in respect of Lowland Ltd.

Required:

(a) Prepare the consolidated statement of financial position of Highland Ltd as at 31 December 20X2. (20 marks)

(b) Explain the purpose of financial statements and the concepts underlying their preparation. (10 marks)

(Total = 30 marks)

Question TWO

(a) Briefly explain possible benefits that could accrue from the development of a single set of accounting standards that could be applied in all countries. (6 marks)

(b) Discuss the elements that might be expected in a regulatory framework within a particular country for published accounts. (14 marks)

Question THREE

The Shabana Property Construction Company Ltd found itself in financial difficulty. The following is a trial balance at 31 December 20X9 extracted from the books of the company.

	DR	CR
	Sh.000	**Sh.000**
Land	156,000	
Ordinary shares of sh.1 each		200,000
5% cumulative Preference shares of Sh.1 each		70,000
8% Debenture 20X2		80,000
Interest Payable on debenture		12,800
Buildings (net)	27,246	
Equipment (net)	10,754	
Goodwill	60,000	
Investment in shares, quoted	27,000	
Inventory and work in progress	120,247	
Accounts receivable	70,692	
Profit and loss account	39,821	
Accounts Payable		96,247
Loans from directors		16,000
Bank overdraft		36,713
	511,760	511,760

The authorized share capital is 200 million ordinary shares of sh.1 each and 100 million 5% cumulative preference shares of sh.1 each.

During a meeting of shareholders and directors, it was decided to carry out a scheme of internal reconstruction which was approved by the High Court. The following scheme has been agreed.

1. Each ordinary share is to be redesignated as a share of sh.0.25.
2. The existing 70 million preference shares are to be exchanged for a new issue of 35 million 8% cumulative preference shares of sh.1 each and 140 million ordinary shares of sh.0.25 each.

3. The ordinary shareholders are to accept a reduction in the nominal value of their shares from sh.1.00 to sh.0.25, and subscribe for a new issue on the basis of 1 for 1at a price of sh.0.30 per share.
4. The Debenture holders are to accept 20 million ordinary shares of sh.0.25 each in lieu of the interest payable. The interest rate is to be increased to 9½%. A further sh.9million of this 9½% Debenture is to be issued and taken up by the existing holders at sh.90 per sh.100.
5. Sh.6 million of director's loan is to be cancelled. The balance is to be settled by issue of 10 million ordinary shares of sh.0.25 each.
6. Goodwill and adverse (Debit) balance on profit and loss account are to be written off.
7. The investment in shares is to be sold at the current market price of sh.60 million.
8. The bank overdraft is to be repaid.
9. Sh.46 million is to be paid to trade creditors now and the balance at quarterly intervals.
10. 10% of the debtors are to be written off.
11. The remaining assets were professionally valued and should be included in the books and accounts as follows:

	Sh.000
Land	90,000
Buildings	80,000
Equipment	10,000
Inventory and Work in progress	50,000

12. It is expected, that due to changed conditions and new management, operating profits will be earned at the rate of sh.50 million per annum after depreciation but before interest and tax. Due to losses brought forward and capital allowances it is unlikely that any tax liability will arise until 2017.

Required:

(a) Post the appropriate accounts to effect the reconstruction, and (12 marks)

(b) Prepare the balance sheet of the company immediately after the reconstruction of the company at 1.1.20X0. (8 marks)

Question FOUR

The balance sheets of KUBWA Ltd and DOGO Ltd as at 31 March 20X3 are given below. The balance sheet of Dogo Ltd, a foreign subsidiary is prepared in Pula, the reporting currency for Dogo. The accepted abbreviation for "Pula" is "PL."

	KUBWA Ltd		DOGO Ltd	
	Sh.000	**Sh.000**	**PL.000**	**PL.000**
Non-current assets:				
Property, plant and equipment	60,000		80,000	
Investments	9,500		-	
		69,500		80,000
Current assets:				
Inventories	30,000		40,000	
Trade receivable	25,000		32,000	
Cash	3,000		4,000	
		58,000		76,000
		127,500		156,000
Issued capital and reserves				
Share Capital				
(sh.0.50 / ½ pula shares)		30,000		40,000
Revaluation reserve		15,000		-
Retained earnings		34,500		44,000
		79,500		84,000
Non-current liabilities:				
Interest-bearing loans	15,000		30,000	
Deferred tax	5,000		9,000	
Current liabilities:		20,000		39,000
Trade payables	12,000		15,000	
Tax	16,000		18,000	
		28,000		33,000
		127,500		156,000

Notes:

1. Investment by Kubwa Ltd in Dogo Ltd

On 1 April 2007, Kubwa purchased 60 million shares in Dogo for 57 million Pula. The retained earnings of Dogo showed a balance of 20 million Pula at that date. The accounting policies of Dogo Ltd are the same as those of Kubwa Ltd except that Kubwa Ltd revalues its land whereas Dogo Ltd carries its land at historical cost. Dogo Ltd's land had been purchased on 1 April 2004. On 1 April 2007, the Fair Value of the land of Dogo Ltd was 6 million Pulas higher than its carrying value in the individual financial statements of that entity. By 31 March 2013, the difference between fair value and carrying value had risen to 11 million Pula. Apart from this accounting policy difference, no other fair value adjustments were necessary when initially consolidating Dogo Ltd as a subsidiary.

2. **Intra-group trading**

On 6 March 2013, Kubwa Ltd sold goods to Dogo Ltd at an invoiced price of sh.6 million, making a profit of 25% on cost. Dogo Ltd recorded these goods in inventory and payables using an exchange rate of 5 pula to sh.1 (there were minimal fluctuations between the two currencies in the month of March 2013). The goods remained in the inventory of Dogo Ltd at 31 March 2013 but on 29 March 2013 Dogo Ltd sent Kubwa Ltd a cheque for 30 million Pula to clear its payable Kubwa Ltd received and recorded this cash on 3 April 2013.

3. **Exchange rates were:**

Date	**Exchange rate (Pula to sh.1)**
1.4.2004	7.0
1.4.2007	6.0
31.3.2012	5.5
31.3.2013	5.0
Weighted average for the year to 31 March 2013	5.2
Weighted average for the dates of acquisition of Closing inventory	5.1

Required:

Translate the balance sheet of Dogo Ltd as at 31 March 2013 into shillings and prepare the consolidated balance sheet of the Kubwa group as at 31 March 2013. (20 marks)

Question FIVE

The balance sheets as at 31 March 20X5 of Azam Ltd and of two entities in which it holds significant investments are shown below:

	Azam Ltd		**Bikin Ltd**		**Chala Ltd**	
ASSETS	**Sh.000**	**Sh.000**	**Sh.000**	**Sh.000**	**Sh.000**	**Sh.000**
Non-current assets:						
Property, plant and equipment	12,500		4,700		4,500	
Investments	18,000		-		1,300	
		30,500		4,700		5,800
Current assets:						
Inventories	7,200		8,000		-	
Trade receivable	6,300		4,300		3,100	
Financial assets	-		-		2,000	
Cash	800		-		900	
		14,300		12,300		6,000
		44,800		17,000		11,800

EQUITY AND LIABILITIES						
Equity						
Called up share						
Capital (sh.1 shares)		10,000		5,000		2,500
Retained earnings		14,000		1,000		4,300
		24,000		6,000		6,800
Non-current liabilities:						
Loans		10,000		3,000		-
Current liabilities:						
Trade payables	8,900		6,700		4,000	
Tax	1,300		100		600	
Short-term borrowings	600		1,200		400	
		10,000		8,000		5,000
		44,800		17,000		11,800

Notes:

1. Investment by Azam Ltd in Bikin Ltd

On 1 April 20X2, Azam Ltd purchased sh.2 million loan notes in Bikin Ltd at par.

On 1 April 20X3, Azam Ltd purchased 4 million of the ordinary shares in Bikin Ltd for sh.7.5 million in cash, when Bikin Ltd's retained earnings were sh.1.5 million.

At the date of acquisition of the shares, Bikin Ltd's property, plant and equipment included land recorded at cost of sh.920,000. At the date of acquisition the land was valued at sh.1,115,000. No other adjustments in respect of fair value were required to Bikin Ltd's assets and liabilities upon acquisition. Bikin Ltd has not recorded the revaluation in its own accounting records.

2. Investment y Azam Ltd in Chala Ltd

On 1 October 20x4, Azam Ltd acquired 1 million shares in Chala Ltd, when its retained earnings were sh.3.9 million. The purchase consideration was sh.4.4 million. Since the acquisition, Azam Ltd has the right to appoint one of the five directors of Chala Ltd. The remaining shares in Chala Ltd are owned principally by three other investors.

No Fair Value adjustments were required in respect of Chala Ltd's assets or liabilities upon acquisition.

3. Goodwill on consolidation

Since acquiring its investment in Bikin Ltd, Azam Ltd has adopted the requirements of IFRS 3 Business combinations in respect of goodwill on consolidation. During March 20X5, it has conducted an impairment review of goodwill. As a result the value of goodwill on consolidation in respect of Bikin Ltd is now sh.1.7 million.

4. Intra-group trading

Bikin Ltd supplies goods to Azam Ltd. On 31 March 20X5, Azam Ltd's inventories included goods purchased at a total cost of sh.1 million from Bikini Ltd. Bikini Ltd's mark-up on goods is 25%.

Required:

(a) Explain, with reasons, how the investments in Bikini Ltd and Chala Ltd will be treated in the consolidated financial statements of the Azam group. (5 marks)

(b) Prepare the consolidated balance sheet for the Azam group at 31 March 20X5. (15 marks)