The Institute of Chartered Accountants of Nigeria (ICAN)

SKILLS LEVEL EXAMINATION

2019

Mock Exam

(3 hours)

Financial reporting

1. This paper consists of **SIX** written test questions of which you must answer **FOUR** questions in total.
   - Section A (40 marks) consists of **one compulsory** question
   - Section B (60 marks) consists of five 20-mark questions.
     You must **answer three questions only**.
2. Ensure your candidate details are on the front of your answer booklet.
3. Answer each question in black ballpoint pen only.
4. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
5. The examiner will take account of the way in which answers are presented.

IMPORTANT

Question papers contain confidential information and must NOT be removed from the examination hall.

DO NOT OPEN THE QUESTION PAPER UNTIL INSTRUCTED

Enter your candidate number in this box

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Section A: 40 marks (compulsory)

1 Barry

Barry has prepared the following draft financial statements for your review

Barry: Statement of profit or loss for year to 31st August 20X1

	₦000
Revenue	30,000
Raw materials consumed	(9,500)
Manufacturing overheads	(5,000)
Increase in inventories of work in progress and finished goods	1,400
Staff costs	(4,700)
Distribution costs	(900)
Depreciation	(4,250)
Interest payable	(350)
Interim dividend paid	(200)
	6,500

Statement of financial position as at 31st August 20X1

	₦000	₦000
Assets		
Non current assets		
Freehold land and buildings		20,000
Plant and machinery		14,000
Fixtures and fittings		5,600
		39,600
Current assets		
Prepayments	200	
Trade receivables	7,400	
Cash at bank	700	
Inventories	4,600	
	–	12,900
Total assets		52,500
Equity and liabilities		
Equity shares		21,000
Revaluation reserve		5,000
Accumulated profit		14,000
Share premium		2,000
Total equity		42,000
Current liabilities		5,300
Non-current liabilities		
8% Debentures 20X5		5,200
Total equity and liabilities		52,500

Additional information:

1 Income tax of ₦2.1 million has yet to be provided for on profits for the current year. An unpaid under-provision for the previous year's liability of ₦400,000 has been identified on 5th September 20X1 and has not been reflected in the draft accounts.

2 There have been no additions to, or disposals of, non-current assets in the year but the assets under construction have been completed in the year at an additional cost of ₦50,000. These related to plant and machinery.

The cost and accumulated depreciation of non-current assets as at 1st September 20X0 were as follows:

	Cost	Depreciation
	₦000	₦000
Freehold land and buildings (land element ₦10 million)	19,000	3,000
Plant and machinery	20,100	4,000
Fixtures and fittings	10,000	3,700
Assets under construction	400	-

3 There was a revaluation of land and buildings during the year, creating the revaluation reserve of ₦5 million (land element ₦1 million). The effect on depreciation has been to increase the buildings charge by ₦300,000. Barry adopts a policy of transferring the revaluation surplus included in equity to retained earnings as it is realised.

4 Staff costs comprise 70% factory staff, 20% general office staff and 10% goods delivery staff

5 An analysis of depreciation charge shows the following:

	₦000
Buildings (50% production, 50% administration)	1,000
Plant and machinery	2,550
Fixtures and fittings (30% production, 70% administration)	700

Required

Prepare the following information in a form suitable for publication for Barry's financial statements for the year ended 31st August 20X1.

(a) Statement of profit or loss ***(8 marks)***

(b) Statement of financial position ***(8 marks)***

(c) Statement of changes in equity ***(6 marks)***

(d) Reconciliation of opening and closing property, plant and equipment ***(8 marks)***

(e) Compare the financial reporting objectives of private and public sector entities and explain the inherent limitations of financial reporting that might prevent financial statements from providing a complete picture of the financial position and financial performance in the public sector.. ***(10 marks)***

(Total: 40 marks)

Section B: 60 marks – answer three out of five questions

2 Brooklyn

Brooklyn is a bio-technology company performing research for pharmaceutical companies. The finance director has contacted your financial consulting company to arrange a meeting to discuss five issues relevant to the preparation of the financial statements for the year to 30th June 20X5. Your initial telephone conversation has provided the necessary background information.

1 On 1st August 20X4 Brooklyn began investigating a new bio-process. On 1st September 20X5, the new process was widely supported by the scientific community and the feasibility project was approved. A grant was then obtained relating to future work. Several pharmaceutical companies have expressed an interest in buying the 'know how' when the project completes in June 20X6. The nominal ledger account set up for the project shows that the expenditure incurred between 1st August 20X4 and 30th June 20X5 was ₦300,000 per month.

2 On 30th September an item of plant was taken out of productive use. The plant manager instructed an agent to sell the plant for no less than ₦175,000. The agent was entitled to a commission of 4% on the selling price. The item is still held in the non-current asset register and the entry shows it was purchased on 1st July 20X2 for ₦260,000 with an estimated useful life of five years and a residual value of ₦60,000. The carrying value of the plant at 30th June 20X5 is ₦140,000.

3 In August 20X5, an employee lodged a legal claim against the company for damage to his health as a result of working for the company for the two years through to 31st March 20X4 when he had to retire due to ill health. He has argued that his health deteriorated as a result of the stress from his position in the organisation. Brooklyn has denied the claim and has appointed an employment lawyer to assist with contesting the case. The lawyer has advised that there is a 25% chance that the claim will be rejected, 50% chance that the damages will be ₦600,000 and 25% chance of ₦1 million. The company has an insurance policy that will pay 10% of any damages to the company. The lawyer has said that the case could take until 30th June 20X8 to resolve. The present value of the estimated damages discounted at 8% is ₦476,280 and ₦793,800 respectively.

4 Brooklyn owns several buildings, which include an administrative office in the centre of London. The company has revalued these on a regular basis every five years and the next valuation is due on 30th June 20X7. Property prices have increased since the last review and particularly for the London premises. The cost of engaging a professionally qualified valuer is very expensive and so to reduce costs the finance director is proposing that the property manager, who is a professionally qualified valuer, should value the London property and that the increase in value should be included in the financial statements. The finance director is of the opinion that the property prices may fall next year.

Required

Prepare notes for your meeting with the finance director which explain and justify the accounting treatment of these issues, preparing calculations where appropriate and identifying matters on which you require further information.

(20 marks)

3 Mbanefo Ltd

The following is an extract of Mbanefo Ltd's balances of property, plant and equipment and related government grants at 1 April 20X7.

	Cost ₦'000	Accumulated depreciation ₦'000	Carrying amount ₦'000
Property, plant and equipment	240	180	60
Non-current liabilities			
Government grants			30
Current liabilities			
Government grants			10

Details including purchases and disposals of plant and related government grants during the year are:

(i) Included in the above figures is an item of plant that was disposed of on 1 April 20X7 for ₦12,000 which had cost ₦90,000 on 1 April 20X4. The plant was being depreciated on a straight-line basis over four years assuming a residual value of ₦10,000. A government grant was received on its purchase and was being recognised in the income statement in equal amounts over four years. In accordance with the terms of the grant, Mbanefo Ltd repaid ₦3,000 of the grant on the disposal of the related plant.

(ii) An item of plant was acquired on 1 July 20X7 with the following costs:

	₦
Base cost	192,000
Modifications specified by Mbanefo Ltd	12,000
Transport and installation	6,000

The plant qualified for a government grant of 25% of the base cost of the plant , but it had not been received by 31 March 20X8. The plant is to be depreciated on a straight-line basis over three years with a nil estimated residual value.

(iii) All other plant is depreciated by 15% per annum on cost

(iv) ₦11,000 of the ₦30,000 non-current liability for government grants at 1 April 20X7 should be reclassified as a current liability as at 31 March 20X8.

(v) Depreciation is calculated on a time apportioned basis.

Required

Prepare extracts of Mbanefo Ltd's statement of profit or loss and statement of financial position in respect of the property, plant and equipment and government grants for the year ended 31 March 20X8.

Note: Disclosure notes are not required. ***(20 marks)***

4 Chris and Caroline

The statements of profit or loss and statements of financial position of two manufacturing companies in the same sector are set out below.

	Chris	Caroline
	₦	₦
Revenue	150,000	700,000
Cost of sales	(60,000)	(210,000)
Gross profit	90,000	490,000
Interest payable	(500)	(12,000)
Distribution costs	(13,000)	(72,000)
Administrative expenses	(15,000)	(35,000)
Profit before tax	61,500	371,000
Income tax expense	(16,605)	(100,170)
Profit for the period	44,895	270,830

	Chris		Caroline	
	₦	₦	₦	₦
Assets				
Non-current assets				
Property	-		500,000	
Plant and equipment	190,000		280,000	
		190,000		780,000
Current assets				
Inventories	12,000		26,250	
Trade receivables	37,500		105,000	
Cash at bank	500		22,000	
		50,000		153,250
Total assets		240,000		933,250
Equity and liabilities				
Equity				
Share capital	156,000		174,750	
Retained earnings	51,395		390,830	
		207,395		565,580
Non-current liabilities				
Long-term debt		10,000		250,000
Current liabilities				
Trade payables		22,605		117,670
Total equity and liabilities		240,000		933,250

Required

Use ratio analysis to compare the profitability, efficiency/liquidity and solvency of the two entities. State, giving reasons, which is the stronger company in each case. ***(20 marks)***

5 Kalejaiye Ltd

Kalejaiye Ltd purchased a 90% share of a locally incorporated company, Okonjo Ltd Limited. Following are the brief details of the acquisition:

Date of acquisition	**January 1, 20X8**
Total paid up capital of Okonjo Ltd Limited (₦10 each)	500,000,000
Purchase price per share	₦30
Net assets of Okonjo Ltd Limited (as per 20X7 audited financial statements)	650,000,000
Fair value of net assets (other than intangible assets) of Okonjo Ltd Limited	1,100,000,000

Okonjo Ltd Limited has an established line of products under the brand name of "SuperKal". On behalf of Kalejaiye Ltd, a firm of specialists has valued the brand name at ₦100 million with an estimated useful life of 10 years at January 1, 20X8. It is expected that the benefits will be spread equally over the brand's useful life.

An impairment test of goodwill and brand was carried out on December 31, 20X8 which indicated an impairment of ₦50 million in the value of goodwill.

An impairment test carried out on December 31, 20X9 indicated a decrease of ₦13.5 million in the carrying value of the brand.

Required

(a) State the IFRS requirements relating to amortisation of intangible assets which have a finite life ***(5 marks)***

(b) Prepare T accounts for goodwill and the brand, showing initial recognition and all subsequent adjustments. ***(10 marks)***

Professional accountants may find themselves in situations where values are in conflict with one another due to responsibilities to employers, clients and the public.

ICAN has a code of conduct called the Professional Code of Conduct for Members which members and student members must follow

Required

(c) List the five fundamental principles set out in the ICAN code and the five categories of threats to these fundamental principles. ***(5 marks)***

(Total: 20 marks)

6 Handel

The draft statements of financial position of three companies as on 30 September 20X9 are as follows.

	Handel	Schubert	Albinoni
Assets	₦	₦	₦
Non-current assets			
Property, plant and equipment	697,210	648,010	349,400
Investments:			
160,000 shares in Schubert	562,000	–	–
80,000 shares in Albinoni	184,000	–	–
Current assets			
Cash	101,274	95,010	80,331
Trade receivables	385,717	320,540	251,065
Inventory	495,165	388,619	286,925
	2,425,366	1,452,179	967,721
Equity and liabilities			
Share capital	600,000	200,000	200,000
Retained earnings	1,050,000	850,000	478,000
	1,650,000	1,050,000	678,000
Current liabilities	375,366	252,179	189,721
Non-current liabilities	400,000	150,000	100,000
	2,425,366	1,452,179	967,721

You are given the following additional information.

(1) Handel purchased the shares in Schubert on 13 October 20X4 when the balance on retained earnings was ₦500,000.

(2) The shares in Albinoni were acquired on 11 May 20X4 when retained earnings stood at ₦242,000.

(3) The following dividends have been declared but not accounted for before the year end.

	₦
Handel	65,000
Schubert	30,000
Albinoni	15,000

(4) Included in the inventory figure for Albinoni is inventory valued at ₦20,000 which had been purchased from Handel at cost plus 25%.

(5) Included in the current liabilities figure of Handel is ₦18,000 payable to Albinoni, the amount receivable being recorded in the receivables figure of Albinoni.

Required

(a) Prepare the consolidated statement of financial position for the Handel group as on 30 September 20X9. ***(15 marks)***

(b) Explain the difference between the accruals basis if accounting and the cash basis of accounting. ***(5 marks)***

(Total: 20 marks)

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