

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## ATC(U) EXAMINATIONS

### LEVEL THREE

#### INTRODUCTION TO FINANCIAL REPORTING – PAPER 12

**TUESDAY, 14 DECEMBER 2004**

#### **INSTRUCTIONS TO CANDIDATES:**

1. Time allowed: **3 hours**
2. Attempt **all** the questions in Section A, any **two** questions in Section B and any **two** questions in Section C.
3. Section A has **one** compulsory question carrying 20 marks.
4. Section B has **three** questions and only **two** are to be attempted. Each question carries 20 marks.
5. Section C has **three** questions and only **two** are to be attempted. Each question carries 20 marks.
6. Please read further instructions on the answer booklet.

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**SECTION A: FINANCIAL ACCOUNTING****Question 1:**

The trial balance for Sonic Limited for the year ended 30 November 2004 is given below.

	<b>Debit</b>	<b>Credit</b>
	<b>Shs '000</b>	<b>Shs'000</b>
Trade receivables / payables	45,000	12,500
Staff advances	34,000	
Accruals		25,500
Deposits by customers		90,000
Share Capital		180,000
Sales/purchases	125,000	850,000
Salaries for marketing staff	22,350	
Salaries for administrative staff	34,000	
Revaluation reserves		450,000
Retained earnings		220,000
Repairs of vehicles used in marketing	22,000	
Repairs of vehicles used by managerial staff	11,000	
Property, Plant and Equipment	530,000	
Other expenses	34,800	
Long-Term Investments/ Borrowings	435,000	585,000
Inventory- 30 November 2003	120,000	
Interest Income/ Expense	128,000	238,000
Deposits made to suppliers	200,000	
Income Tax expense/ Liability	23,400	13,250
Foreign currency gain		32,000
Fines on a lost court case	12,500	
Dividends paid	2,500	
Depreciation of marketing vehicles	24,340	
Depreciation of managers' vehicles	14,120	
Bank Balances/overdrafts	918,240	40,000
	<b><u>2,736,250</u></b>	<b><u>2,736,250</u></b>

**Additional Information:**

- (i) Deposits by customers relate to receipts from customers in 2003. The goods for which the deposits were made were duly transferred to these customers in 2004. **IAS 18: Revenue** has to be complied with.

- (ii) Inventory at 30 November 2004 had a selling price of Shs.150,000,000, with costs of disposal estimated at Shs. 20,000,000. The inventory had a historical cost of Shs. 160,000,000. Inventory is accounted for in accordance with **IAS 2: Inventories**.
- (iii) 25% of the borrowings are repayable by 30 November 2005. 20% of the long-term investments is recoverable by 30 November 2005. Sonic makes a distinction between current and non-current assets.
- (iv) Salaries for November 2004 for the marketing staff totalling Shs. 5,000,000 were paid in the first week of December 2004. By November 2004 no entry had been made for the unpaid salary.
- (v) Included in Property, Plant and Equipment is a Mercedes Benz motor vehicle used by the general manager that has not been depreciated because its market value is higher than its net book value. The benz, which cost Shs. 75 million was acquired at the start of 2004, after the assets of the company had been revalued. Its useful life is estimated to be 10 years with no residual value. **IAS 16: Property Plant and Equipment** should be strictly adhered to.

**Required:**

Prepare:

- (a) The Income Statement for Sonic Limited for the year ended 30 November 2004 classifying expenses by function. **(10 marks)**
- (b) Sonic's Balance Sheet as at 30 November 2004. **(10 marks)**

**Hint:** Your answer should be presented in accordance with the guidance in **IAS 1: Presentation of Financial Statements**.

**(Total 20 marks)**

**Question 2**

- (a) With reference to **IAS 11: Construction Contracts**, explain how the stage of completion of a construction contract can be determined. **(6 marks)**
- (b) Under **IAS 11 Construction Contracts**, how would the following be accounted for?
- (i) A contract whose outcome cannot be ascertained reliably. **(2 marks)**
  - (ii) A contract that has an overall expected future net loss. **(2 marks)**
  - (iii) A bonus contingent on meeting the deadline of contract completion. **(2 marks)**
- (c) The following information relates to a contract that Bargainer Contractors have been working on. The contract relates to the construction of a one-stop shopping center that will be the first of its kind in Entebbe. Kunta Kinte Limited is the customer.

It is a fixed price contract for Shs. 4.5 billion. The initial payment agreed in the contract was Shs. 3 billion. Initially Bargainer had estimated that the contract costs would be Shs 4 billion. It takes 3 years to build such a complex. Works commenced on 1 December 2002.

By 30 November 2003, Bargainer's recalculations showed that the contract costs would increase by Shs. 25 million over the initial estimate. The costs incurred are as follows:

	<b>Year ended 30 November</b>	
	<b>2003</b>	<b>2004</b>
Contract costs incurred	Shs 800 million	Shs 950 million

In the year ended 30 November 2004, Kunta Kinte Limited approved a variation that resulted in an increase in contract amount of Shs. 100 million and estimated additional contract costs of Shs. 75 million.

On 30 November, 2004 costs incurred included Shs. 50 million for standard materials stored at the site to be used in the year that will end on 30 November 2005 to complete the contract. Bargainer's accounting policy is to calculate the stage of completion using the costs approach.

**Required:**

Calculate the contract revenue, contract costs and contract profit that would be included in the income statement of Bargainer Limited for years ended or ending 30 November 2003, 30 November 2004, and 30 November 2005.

**(8 marks)**  
**(Total 20 marks)**

**Question 3**

The trial balances for the years ended 30 November 2003 and 2004 for AGOA Ltd are given below.

	<b>2004</b>		<b>2003</b>	
	Shs' 000	Shs '000	Shs '000	Shs '000
	<b>Debit</b>	<b>Credit</b>	<b>Debit</b>	<b>Credit</b>
Bank Balances	40,000	20,000	32,000	16,000
Depreciation expense	8,000		6,400	
Dividends paid	2,500		2,000	
Foreign currency gain (Realised)		15,000		12,000
Income tax expense/ liability	3,500	2,000	2,800	1,600
Interest Income/ Expense	1,850	1,910	1,480	1,528
Inventory	28,000		22,400	
Long-Term investments/ borrowings	33,000	43,900	26,400	35,120
Other expenses	65,000		52,000	
Proceeds from disposed of assets		16,000		12,800
Property, Plant and Equipment	150,000		120,000	
Retained earnings		64,000		51,200
Revaluation reserves		88,000		70,400
Sales/Purchases	32,000	43,000	25,600	34,400
Share Capital		56,500		45,200
Accruals		32,100		25,680
Staff advances	23,100		18,480	
Trade receivables/ payables	<u>46,400</u>	<u>50,940</u>	<u>37,120</u>	<u>40,752</u>
	<b><u>433,350</u></b>	<b><u>433,350</u></b>	<b><u>346,680</u></b>	<b><u>346,680</u></b>

**Additional Information:**

- (i) The change in long-term investments represents new investments paid for in cash.
- (ii) The increase on borrowings is due to new cash borrowings.
- (iii) The disposed asset had a net book value of Shs. 12,000,000 at the time of its disposal. The disposal has not yet been cleared from the balances of Property, Plant and Equipment.

- (iv) The increase in revaluation reserve arose from the revaluation of all the company's vehicles.

**Required:**

Prepare AGOA Ltd's Cash Flow Statement as at 30 November 2004, using the indirect method of **IAS 7: Cash Flow Statements**.

**(20 marks)**

**Question 4**

- (a) Distinguish fund accounting and commitment accounting as used in the public sector.

**(5 marks)**

- (b) The following transactions have been extracted from Kigobya Local Government's accounting records for the year ended 30 June 2004.

	<b>Budget 2003/04</b>	<b>Actual 2003/04</b>
<b>Salaries for health staff</b>	<b>1,669,000</b>	<b>1,235,320</b>
<b>Funded by:</b>		
Immunisation Fund	56,000	72,800
IFAD- fund	340,000	272,000
UNICEF youth fund	218,000	283,400
Local Revenue	987,000	552,720
Central Government releases	68,000	54,400
<b>Salaries for Other staff</b>	<b>1,335,200</b>	<b>1,166,880</b>
<b>Funded by:</b>		
Immunisation Fund	44,800	58,240
IFAD- fund	272,000	152,320
UNICEF youth fund	174,400	226,720
Local Revenue	789,600	631,680
Central Government releases	54,400	97,920
<b>Travel related costs</b>	<b>1,068,160</b>	<b>790,605</b>
<b>Funded by:</b>		
Immunisation Fund	35,840	46,592
IFAD- fund	217,600	174,080
UNICEF youth fund	139,520	181,376
Local Revenue	631,680	353,741
Central Government releases	43,520	34,816

	<b>Budget 2003/04</b>	<b>Actual 2003/04</b>
<b>Repairs and Maintenance</b>	<b>854,528</b>	<b>746,804</b>
<b>Funded by:</b>		
Immunisation Fund	28,672	37,274
IFAD- fund	174,080	97,485
UNICEF youth fund	111,616	145,101
Local Revenue	505,344	404,275
Central Government releases	34,816	62,669
<b>Income</b>	<b>6,750,000</b>	<b>6,833,000</b>
Immunisation Fund	1,800,000	2,340,000
IFAD- fund	1,400,000	1,120,000
UNICEF youth fund	1,450,000	1,885,000
Local Revenue	800,000	448,000
Central Government releases	1,300,000	1,040,000

**Required:**

Using Fund Accounting prepare the respective Income and Expenditure Statements.

**(15 marks)**  
**(Total 20 marks)**

**SECTION C: AUDITING****Question 5**

A recently recruited audit assistant has identified the following issues for your attention and further discussions with the Audit Manager in relation to the audit of Laisefair Limited for the year ended 30 November, 2004.

- (i) Sales of Shs. 5 million were made to a company in which Laisefair holds 80% shares.
- (ii) The auditors did not attend the stock take of some inventory valued at Shs. 500,000 because the client did not disclose all the inventory locations.
- (iii) The client has refused to charge depreciation on property, plant and equipment on the grounds that last year there was no depreciation charged. The directors do not want to distort the comparatives.
- (iv) Proforma invoices support most of the payments, with no further underlying documents.
- (v) Some debtors have not replied the auditors' independent confirmation letters and yet they have not settled the outstanding balances to date.

- (vi) The non-current assets of the company are not engraved with the company's initials and neither are they insured.
- (vii) The directors have insisted that their fees should be disclosed as part of salaries and wages without further analysis or disclosures.
- (viii) A bill currently being considered by Parliament may prohibit 80% of the company's business activities.
- (ix) On 5 December 2004 the company lost a court case and was ordered to pay Shs. 55 million. Since court ruled after the year-end, the directors do not want any mention of this unfortunate incident anywhere in the financial statements.
- (x) The register of members had 250 fully registered members. The company is registered as private company limited by shares.

**Required:**

Write a MEMO to the audit manager giving your views on the way forward on each of the issues raised by the audit assistant.

**(2 marks for each issue).**

**(Total 20 marks)**

**Question 6**

- (a) What is the importance of documenting the auditors' work and findings through the use of working papers?  
**( 6 marks)**
  - (b) Give the qualities of a good audit working paper?  
**(10 marks)**
  - (c) Under what circumstances would the auditor be permitted to give working papers to third parties?  
**(4 marks)**
- (Total 20 marks)**

**Question 7**

- (a) Why do auditors, before commencing the detailed audit tests, seek to understand the business, accounting and internal control systems of a client?  
**(8 marks)**
  - (b) Write short notes on the following types of Internal Controls:
    - (i) Detection controls. **(4 marks)**
    - (ii) Preventive controls. **(4 marks)**
    - (iii) Supportive controls. **(4 marks)**
- (Total 20 marks)**