

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

ATC(U) EXAMINATIONS

LEVEL THREE

INTRODUCTION TO FINANCIAL REPORTING – PAPER 12

TUESDAY, 8 DECEMBER 2009

INSTRUCTIONS TO CANDIDATES:

1. Time allowed: **3 hours 15 minutes**.
The first 15 minutes of this examination have been designated for reading time. You may not start to write your answer during this time.
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.

SECTION A**Question 1**

A list of account balances of Magma, a Limited Liability Company, at 31 October 2009 is given below:

	Dr Shs '000'	Cr Shs '000'
Trade accounts receivable and payable	20,700	11,400
Inventory 1 November 2008	13,500	
Directors' remuneration	2,610	
Administration salaries	9,210	
Salesmen's salaries and commissions	5,550	
General administration expenses	1,740	
Other operating expenses	2,550	
General distribution costs	1,470	
Loan interest paid	300	
Interim dividend paid	120	
Allowance for doubtful debts 1 November 2008		600
Bank balance		11,190
Sales revenue		85,800
Purchases	54,000	
Non-current assets at cost	54,000	
Accumulated depreciation 1 November 2008		11,700
15% loan (repayable 2015)		3,000
Issued share capital (400,000 ordinary shares)		12,000
Share premium		3,900
Retained earnings, 1 November 2008	<u>-</u>	<u>26,160</u>
	<u>165,750</u>	<u>165,750</u>

The following information should be allowed for:

1. Inventory at 31 October 2009 amounted to Shs 15 million. Inventories are valued at the lower of cost and net realizable value.
2. A review of trade receivables showed that it was necessary to write off bad debts totaling Shs 4 million and the allowance for doubtful debts be adjusted to 5% of the remaining balance.
3. Depreciation should be charged at 12.5% per annum on cost at the end of the year and allocated to cost of sales.
4. Tax payable for the year amounted to Shs 450,000.
5. The sales revenue represents the net invoiced value of all goods sold during the year.
6. The company prepares its accounts on the historic cost basis of accounting.

Required:

Prepare, in the form suitable for publication, Magma Ltd's:

- (a) statement of comprehensive income for the year ended 31 October 2009. **(10 marks)**
 - (b) statement of financial position as at 31 October 2009. **(8 marks)**
 - (c) notes to the financial statements as Note 1: Accounting policies. **(2 marks)**
- (Total 20 marks)**

SECTION B**Question 2**

Alpha Ltd disclosed the following reserves in its financial statements as at 30 September 2008:

	Shs million
Share premium	1,320
Revaluation surplus	2,160
Retained earnings	2,451

During the year ended 30 September 2009, the following transactions occurred:

- (i) Alpha Ltd issued 100,000 Shs 10,000 additional ordinary shares at Shs 15,000 each, fully paid, and 150,000 10% Shs 5,000 preference shares at Shs 8,000 each, fully paid. The total ordinary shares held was raised to 200,000 Shs 10,000 ordinary shares.
- (ii) Alpha Ltd revalued its freehold property from Shs 4 billion to Shs 4.8 billion. Before this revaluation, it had sold an unused property for Shs 500 million. This property had previously been revalued from its purchase cost of Shs 135 million to Shs 300 million. No depreciation is provided for on freehold property.
- (iii) The company made after tax profits of Shs 891 million including the surplus on disposal of the property in (ii) above.
- (iv) Interim dividends for the year were Shs 160 per ordinary share together with the payment of a full year's dividend on the new preference shares.

Required:

Prepare a statement showing the changes in the reserves of Alpha Ltd for the year ended 30 September 2009.

(20 marks)

Question 3

Omega Ltd supplies gas to its customers in returnable cylinders which remain the property of Omega Ltd. The cylinders cost Shs 150,000 each and they are charged out to customers at Shs 180,000 each. Upon return of the cylinders, the customers are credited with Shs 120,000 each.

For inventory counting purposes, all cylinders are valued at Shs 100,000 each.

You are advised that:

	30 November 2009	30 November 2008
Cylinders held by Omega Ltd	0	2,000
Cylinders held by customers	9,500	7,000

During the year, 30,000 new cylinders were purchased, 52,000 were invoiced to customers and 49,500 were returned. On inspection, 1,200 cylinders required repairs costing Shs 36 million and 300 cylinders had to be sold as scrap for Shs 50,000 each.

Required:

Prepare a:

- (a) cylinders inventory account. **(8 marks)**
- (b) cylinders suspense account. **(6 marks)**
- (c) statement showing profit or loss on dealing in cylinders during the year ended 30 November 2009 for Omega Ltd.

(6 marks)

(Total 20 marks)

Question 4

- (a) The Local Governments Financial and Accounting Regulations, 1998 stipulate that no expenditure for which there is either insufficient or no provision in the approved estimates may be incurred until a supplementary estimate has been approved.

Required:

Identify and explain any **three** categories of revisions that may be made in approved estimates.

(6 marks)

- (b) The Public Finance and Accountability Act, 2003 requires the Accountant General to submit certain accounts to the Auditor General.

Required:

- (i) Explain any **two** duties of the Accountant General. **(4 marks)**

- (ii) Identify and briefly explain any **five** accounts that the Accountant General is required to submit to the Auditor General.

(10 marks)

(Total 20 marks)

SECTION C

Question 5

Large organisations have found it useful to have internal auditing, in addition to external auditing.

The functions of internal auditors are determined by management and vary greatly from organisation to organisation.

Required:

- (a) Define the term 'internal auditing'.
(2 marks)
- (b) Internal auditors are employees of an organisation and thus independence is not always easy to achieve. Identify **four** ways in which the independence of internal auditors can be achieved.
(4 marks)
- (c) The internal auditor's job is to appraise the activities of others. State **four** different checks that the internal auditors' activities are directed to.
(4 marks)
- (d) Explain any **five** essential elements of internal auditing.

(10 marks)

(Total 20 marks)

Question 6

The auditor has a duty to verify all the assets appearing on the statement of financial position and also a duty to verify that there are no other assets which ought to appear on the statement of financial position.

Required:

- (a) Explain **five** aspects that must be verified for each asset.
(10 marks)
- (b) Explain **three** ways in which verification of bank balances is effected.
(6 marks)
- (c) How should land be disclosed in the annual financial statements and notes attached thereto?

(4 marks)

(Total 20 marks)

Question 7

Auditors should carry out procedures designed to obtain sufficient appropriate audit evidence to determine with reasonable confidence whether the financial statements are free from material misstatements.

It is not necessary that auditors should ensure that financial statements are absolutely 100% accurate.

Audit sampling can provide reasonable assurance that some elements of the financial statements are free from material misstatements.

Required:

- (a) Define the term 'audit sampling'.
(2 marks)
- (b) State **three** factors which may be taken into account in considering whether or not to sample.
(8 marks)
- (c) Give **five** reasons why a complete check of all transactions and balances of an entity may not be required of an auditor.
(10 marks)

(Total 20 marks)