

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

ATC(U) EXAMINATIONS

LEVEL THREE

INTRODUCTION TO FINANCIAL REPORTING – PAPER 12

MONDAY, 1 JUNE 2015

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. Section **A** has **one** compulsory question carrying 20 marks.
3. Section **B** has **three** questions and only **two** are to be attempted. Each question carries 20 marks.
4. Section **C** has **three** questions and only **two** are to be attempted. Each question carries 20 marks.
5. Write your answer to each question on a fresh page in your answer booklet.
6. Please, read further instructions on answer booklet, before attempting any question

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SECTION A

This section has one compulsory question to be attempted

Question 1

The following trial balance was extracted from the books of New Hope Ltd for the year ended 31 December 2014.

	Shs '000'	Shs '000'
Ordinary share capital		660,000
Share premium		140,000
Land	150,000	
Buildings	60,000	
Equipment	40,000	
10% treasury bills	20,000	
Goodwill	10,000	
Inventory 31 December 2013	50,000	
Accounts receivable & payable	155,000	75,000
Bank overdraft		15,000
Cash balance	899,500	
Purchases & sales	516,000	900,000
Return outwards		24,500
Return inwards	20,200	
Carriage inwards	15,500	
Carriage outwards	12,800	
Discounts allowed & received	18,000	7,000
Prepaid salaries	5,250	
Accrued rent		3,500
Rent	11,500	
Salaries	6,200	
Utilities	2,000	
Interest on bank loan	10,000	
Bad debts	3,050	
Provision for bad debts		10,000
Provision for depreciation:		
Buildings		12,000
Equipment		8,000
15% bank loan		100,000
10% debentures		50,000
	<u>2,005,000</u>	<u>2,005,000</u>

Additional information:

- 1 Inventory on 31 December 2014 was valued at Shs 30 million.
- 2 Salaries Shs 3.55 million and rent Shs 2 million were outstanding at 31 December 2014.
- 3 Provision for bad debts to be adjusted to Shs 5 million.
- 4 Depreciation to be provided on non-current assets at 10% on reducing balance.
- 5 Goodwill is to be amortized over a period of 4 years starting 2014.
- 6 Interest on treasury bills was accrued.
- 7 The interest on bank loan and on debentures was outstanding at 31 December 2014.

Required:

Prepare, for New Hope Ltd for the year ended 31 December 2014, and in a form suitable for publication, a statement of:

- (i) profit or loss and other comprehensive income. **(11 marks)**
 - (ii) financial position. **(9 marks)**
- (Total 20 marks)**

SECTION B

Attempt two of the three questions in this section

Question 2

- (a) In March 2014, Seiler Co. Ltd (SCL) purchased land for construction of a factory at Shs 100 million. SCL paid Shs 1 million to demolish a building that was on the land make the land more suitable for use. The sale of materials from the demolished building realised Shs 500,000. In addition, SCL made the following payments:

Particulars	Shs '000'
Title processing fees and related charges	3,000
Filling up of gulleys created by rain water	1,500
Clearing and grading for construction works to begin	5,000
Construction contractor's fees	10,000
Compensation to squatters	3,500
Construction of parking yard for new factory	2,000
Compound designs for new factory	5,000
Payments to the workers for compound designs	500

Required:

Determine the cost of land to be recorded in the financial statements of Seiler Co. Ltd for the year ended 31 December 2014.

(5 marks)

- (b) The following balances were extracted from the financial statements of Sparkle Investments Ltd as at 1 January 2014.

	Shs '000'
Ordinary share capital Shs 100 per share	1,000,000
Share premium	500,000
Retained earnings	650,000
General reserve	300,000
Revaluation reserve	150,000
Translation reserves	120,000
Capital redemption reserve	321,000

Additional information:

- (i) The profit for the year ended 31 December 2014 was Shs 250 million.
- (ii) During the year to 31 December 2014, land and buildings were revalued by Shs 130 million and Shs 120 million respectively.
- (iii) During the year to 31 December, 2014 20 million ordinary shares were issued at Shs 120 per share.
- (iv) A dividend of Shs 300 million was declared on 31 December 2014.
- (v) Shs 180 million and Shs 125 million was transferred to the general and capital redemption reserves respectively.
- (vi) At 31 December 2014, the translation reserve had increased to Shs 150 million.

Required:

Prepare a statement of changes in equity as at 31 December 2014 for Sparkle Investments Ltd.

(15 marks)**(Total 20 marks)****Question 3**

- (a) Explain the factors that have shaped financial reporting.

(6 marks)

- (b) State and briefly explain any **four** elements of financial statements.

(4 marks)

- (c) Describe the different components of financial statements and their objectives according to IAS 1: Presentation of Financial Statements.

(10 marks)**(Total 20 marks)**

Question 4

A budget is a dynamic document with key elements of legislative control over Government units. The executive branch of the Government unit proposes the budget, the legislative branch reviews, modifies and enacts the budgets and finally the executive branch implements the budget.

Required:

- (a) Explain the main functions of an annual budget of a town council. **(4 marks)**
- (b) Lego Town Council (LTC) authorized the construction of a new council hall on 1 July 2013. This hall is expected to cost Shs 1 billion.

The financing for the project is as follows:

- Shs 500 million from an issue of a 10% bond,
- Shs 400 million from a conditional grant from the central government,
- Shs 100 million from the Council Revenue Reserve.

Transactions and events during the year to 30 June, 2014 were as follows:

- | | | |
|---|--------------------|---|
| 1 | 1 July, 2013 | LTC transferred Shs.100 million from the revenue reserve to the capital reserve to partially fund the construction of the hall. |
| 2 | 5 July, 2013 | LTC paid Shs 40 million for planning and architect's fees by Electronic Funds Transfer (EFT). This expenditure is included in the cost of the hall. |
| 3 | 10 July, 2013 | the contract was awarded to the lowest bidder for Shs 950 million. The contract is accounted for in accordance with international accounting standards dealing with construction contracts. |
| 4 | 10 September, 2013 | the bonds were sold for Shs 500 million. The interest for the year to 30 June 2014 had not been paid by 30 June, 2014. |
| 5 | 15 June, 2014 | Received bill for Shs 475 million from the contractor. By date work on construction was certified to be 50% complete. |
| 6 | 30 June, 2014 | paid bill from contractors less 10% retainer by EFT. |

Required:

- (i) Prepare journal entries to record the above transactions in the books of Lego Town Council.

(9 marks)

- (ii) Prepare extracts that would appear in the financial statements of Lego Town Council on 30 June 2014.

(7 marks)

(Total 20 marks)

SECTION C

Attempt two of the three questions in this section

Question 5

The audit evidence should, in total, enable the auditor to form an opinion on the financial statements. In forming such an opinion, the auditor does not normally examine all the information that is available to him/ her because he/ she can reach a conclusion about balances, class of transactions or internal controls by way of judgmental or statistical sampling procedures.

Required:

- (a) Explain the factors auditors should consider when designing and selecting an audit sample **(8 marks)**
- (b) The auditor may rely on appropriate evidence obtained by substantive testing to form his/ her opinion, provided that sufficient of such evidence is obtained or he/ she may be able to obtain assurance from the existence of a reliable system of internal control, and thereby reduce the extent of substantive testing.

Required:

Explain the techniques of obtaining evidence by performing compliance and substantive procedures.

(8 marks)

- (c) The auditor may gain increased assurance when audit evidence obtained from different sources or of a different nature is consistent. In that case, he/ she may obtain a cumulative degree of assurance higher than that he attaches to the individual items of evidence by themselves.

Required:

Explain the criteria for assessing the reliability of audit evidence.

(4 marks)

(Total 20 marks)

Question 6

Audit risk is defined as the risk of significant error or mistake not detected either by the organisation's system of controls or the auditor's own procedures.

Audit risk must be assessed at both the organisational level and at transactional level.

The risks of material misstatement are split into two components: 'inherent risk' and 'control risk'.

Required:

- (a) State:
- (i) any **five** factors that influence inherent risk at organisational level. **(10 marks)**
 - (ii) any **two** factors that influence inherent risk at transactional level. **(4 marks)**
- (b) Define the term 'control risk' and explain any **three** factors that influence control risk. **(6marks)**
- (Total marks 20)**

Question 7

Bodo & Associates, a firm of certified public accountants, have been appointed to audit the financial statements of a petroleum company which is located in Busunju, central Uganda. This is going to be their first assignment to audit a petroleum company. Bodo & Associates have invited you to advise on how to seek technical advice on some aspects of petroleum industry.

Required:

Explain:

- (i) The term 'audit expert'. **(2 marks)**
 - (ii) **Four** types of experts and the type of expertise that would be required from each type of expert. **(8 marks)**
 - (iii) Factors to consider when deciding whether an auditor needs to have a specialist opinion. **(4 marks)**
 - (iv) Factors which may influence the auditor to rely upon or not to rely upon the work of an expert. **(6 marks)**
- (Total 20 marks)**