

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL FOUR

FINANCIAL REPORTING - PAPER 16

MONDAY, 16 DECEMBER 2002

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Section **A** has **one** compulsory question carrying 60 marks.
3. Section **B** has **three** questions and only **two** questions are to be attempted.
Each question carries 20 marks.
4. Please, read further instructions on the answer book.

SECTION A

Question 1

The following is **an extract** list of account balances for A Ltd on 30 November 2002:

		DR Shs. million	CR Shs. million
Lease rentals	Note 1	100	
Construction contract costs	Note 2	200	
Construction contract progress billings received	Note 2		450
Investment in X Ltd.	Note 3	800	
Investment in Y Ltd.	Note 4	1,200	
Investment in Dodi's Funfare Park	Note 5	500	
Convertible loan stock	Note 6		300
Investment properties	Note 7	800	

Notes:

1. Finance Lease:

A lease rental of Shs. 100 million was paid on 1 December 2001. It is the first of five annual payments in advance for the rental of an item of plant that has a cash purchase price of Shs. 336 million. The auditors have advised that this is a finance lease and have calculated the implicit interest rate in the lease as 25% per annum. The useful economic life of the plant is 5 years.

2. Construction Contract

The figures in respect of construction contract balances relate to a two-year contract entered into on 1 December 2001. Details relating to this contract are:

	Shs. million
Contract price	800
Estimated total contract costs	600
Value of work certified	500

The costs incurred during the year to 30 November 2002 include Shs. 25 million relating to remedial work. These costs were not included in the original estimates.

A Ltd. accrues profits on its construction contracts using the percentage of completion method as measured by the percentage of the cost to date compared to the total estimated contract cost.

3. Jointly Controlled Entity

On 30 November 2002, A Ltd. acquired 50% of the ordinary share capital of X Ltd. at a cost of shs. 800 million. The other 50% of the ordinary share capital of X Ltd. is owned by B Ltd. Both A Ltd. and B Ltd. consider X Ltd. to be a jointly controlled entity.

At 30 November 2002, the following fair values were attributed to the net assets of X Ltd.

	Shs. million
Property, plant and equipment	1,000
Current assets	400
Current liabilities	<u>(200)</u>
	<u>1,200</u>

4. Acquisition of a Subsidiary

A Ltd. acquired 80% of the ordinary share capital of Y Ltd. on 30 November 2002.

The balance sheet of Y Ltd. at 30 November 2002 was:

	Shs. million	Shs. million
Non-current assets		
Intangible assets – Trade marks	200	
Property, plant and equipment	<u>700</u>	
		900
Current assets		
Inventories	300	
Receivables	200	
Cash	<u>100</u>	
		<u>600</u>
Total assets		<u>1,500</u>
Capital and reserves		
Issued share capital (Ordinary shares of Shs. 100 each)	500	
Share premium account	100	
Accumulated profits	<u>250</u>	
		850
Non current liabilities		
Borrowings	250	
Provisions	<u>100</u>	
		350
Current liabilities		<u>300</u>
		<u>1,500</u>

Additional information:

- (a) The intangible assets of Y Ltd. were trade-marks currently utilised by the company. The directors felt that they were worth Shs. 300 million but there was no readily ascertainable market value at the balance sheet date, nor any information to verify the director's estimated value.
- (b) The market value of property, plant and equipment was Shs. 800 million on 30 November 2002.
- (c) The replacement cost of inventories was Shs. 350 million and its net selling value was Shs. 400 million.
- (d) Receivables and payables due within one year are stated at the amounts expected to be received and paid.
- (e) The non-current borrowings consist of a long-term loan with a bank. The initial loan on 1 December 2000 was Shs. 200 million at a fixed interest rate of 25% per annum. The total amount of the interest is to be paid at the end of the loan period on 30 November 2005. The current bank-lending rate is 20% per annum.
- (f) The provision related to costs of restructuring of Y Ltd. The restructuring provision was set up by the directors of Y Ltd. prior to A Ltd. acquiring shares in Y Ltd. There is a formal plan for restructuring and the details of the restructuring have been communicated to parties affected by it. In addition, A Ltd. wishes to make a provision for future losses of Shs. 180 million which it feels will be incurred to rationalise the group.
- (g) A wishes to use the allowed alternative in IAS 22 for the treatment of minority interest.
- (h) A Ltd. paid Shs. 1,200 million for the 80% of the ordinary share capital of Y Ltd.

5. Purchase of Business and Impairment of Assets

A Ltd. acquired Dodi's Funfare Park for Shs. 500 million on 1 November 2002. The summarised balance sheet at fair values of Dodi's Funfare Park on 1 November 2002, reflecting the terms of the acquisition was:

	Shs. Million
Goodwill	100
Property	250
Equipment	<u>150</u>
	<u>500</u>

The carrying value of the property is based on its value in use and the equipment is valued at its net selling price.

On 15 November 2002, because of an accident, some of the equipment with net selling price of Shs. 50 million was damaged beyond repair. As no replacement could be found for this equipment, there was a reduction in the number of people using Dodi's Funfare Park. The estimated value in

use of the whole business after the accident was assessed at Shs. 350 million.

The amount for the depreciation on property and equipment for the period 1 November 2002 and 30 November 2002 is immaterial.

6. Convertible Loan Stock

On 1 December 2001 A Ltd. issued Shs. 300 million 15% convertible loan stock at par. The stock is convertible into equity shares, or redeemable at par, on 30 November 2006, at the option of the stockholders. The terms of the conversion are that each Shs. 5,000 of loan stock will be convertible into 1 equity share of A Ltd. Interest is paid on the last day of the financial year. The current market rate of interest is 20% per annum.

7. Properties

A Ltd. acquired three properties on 1 December 2001. All three properties are rented out. Details of these properties and their valuations on 30 November 2002 are:

Property	Type	Life	Cost on 1 Dec. 2001 Shs million	Value on 30 Nov. 2002 Shs million
North	freehold	50 years	250	280
East	freehold	50 years	400	375
West	freehold	15 years	150	160

A Ltd's policy is to carry all non-investment properties on cost and investment properties at fair values.

Property North is let to a subsidiary of A Ltd. on normal commercial terms.

The accountant of A Ltd. is unsure as to how the above items should be dealt with in the accounts of A Ltd.

Required:

Write a report explaining:

The requirements of applicable IASs to the transactions in notes 1 to 7.
(22 marks)

The effect on A Ltd.'s balance sheet on 30 November 2002 and A Ltd.'s income statement for the year ended 30 November 2002 on correct application of relevant IAS's to the transactions in notes 1 to 7. Ignore tax implications.

(38 marks)
(Total 60 marks)

Question 2

IAS 12 'Income Taxes' utilizes a balance sheet focus in accounting for deferred taxation which is calculated on the basis of temporary differences.

- (a) Explain what the terms 'Balance Sheet Focus' and 'Temporary differences' mean in relation to deferred taxation. Your explanation should also discuss the terms 'taxable temporary differences' and 'deductible temporary differences'.

(10 marks)

- (b) X Ltd, a company listed on the Uganda Securities Exchange has decided to adopt the provisions of the IASs for the first time in its financial statements for the year ended 30 November 2002.

Additional information.

- (i) The carrying amount of the property, plant and equipment is Shs. 2,000 million and the tax base is Shs. 800 million.

Other taxable temporary differences amount to Shs. 300 million as at 30 November 2000.

- (ii) During the year, X Ltd had supplied a wholly owned subsidiary with inventory amounting to Shs. 80 million at a profit of 25% on selling price. The inventory had not been sold by the year-end and the tax rate applied to the subsidiary's profit is 25%.

- (iii) Under the tax law of Uganda, tax losses can be carried forward indefinitely. The accumulated tax losses as at 1 December 2001 were Shs. 3,500 million. The taxable profits for the year ending 30 November 2002 were anticipated to be as follows:

2002	2003	2004
Shs million	Shs million	Shs million
700	800	900

The availability of taxable profits in 2004 and beyond is based on a launch of a new product sometime during 2003. A number of attempts have been made in the past to launch this new product but without much success.

- (iv) The income tax rate is assumed to be 30% for the foreseeable future.
(v) There are no other temporary differences other than those set out above.
(vi) The directors of X Ltd have calculated the opening balance of deferred tax asset using IAS 12 to be Shs. 400 million.

Required:

Calculate the provision for deferred tax required by X Ltd at 30 November 2002 and the deferred tax expense in the income statement for the year ended 30 November 2002.

(10 marks)
(Total 20 marks)

Question 3

- (a) IAS 41: Agriculture becomes operative for annual financial statements covering periods beginning on or after 1 January 2003 with earlier application encouraged.

Required:

Explain how biological assets and agricultural produce should be accounted for under IAS 41: Agriculture.

(10 marks)

- (b) Kisozi Farm Company, a public limited company, deals in cattle farming. The company owns one farm and, on 1 December 2001, had a herd of 100 two year old animals. 10 animals aged 2.5 years were purchased on 1 June 2002, for Shs. 1,250,000 each and 10 new animals were born on 1 June 2002. No animals were sold or disposed of during the period.

Per unit fair values less estimated point-of-sale costs were as follows:

	Shs
Two year old animal at 1 December 2001	1,200,000
New born animal at 1 June 2002	350,000
2.5 year old animal at 1 June 2002	1,250,000
New born animal at 30 November 2002	360,000
0.5 year old animal at 30 November 2002	425,000
Two year old animal at 30 November 2002	1,275,000
2.5 year old animal at 30 November 2002	1,310,000
Three year old animal at 30 November 2002	1,360,000

Required:

Compute the value of the herd as at 1 December 2001, 30 November 2002 and changes in value of the herd for the year to 30 November 2002. The changes in value of the herd for the year to 30 November 2002 should further be analysed into changes due to price change and physical change respectively.

(10 marks)
(Total 20 marks)

Question 4

At 1 December 2001 X Ltd. held 75% of the 5 million Shs. 100 ordinary shares issued by Y Ltd. which it had acquired on 1 December 2000 at a cost of Shs. 750 million when the reserves of Y Ltd. showed a credit balance of Shs. 100 million. On 1 December 2000, the fair value of Y Ltd.'s net assets was equal to their carrying value.

On 1 April 2002 X Ltd. acquired 90% of the 3 million Shs. 100 ordinary shares issued by Z Ltd. at a cost of Shs. 450 million. On 1 April 2002, the fair value of Z Ltd.'s net assets was equal to their carrying value. On 1 June 2002 X Ltd. sold shares in Y Ltd. for Shs. 800 million leaving it a holding of 25%. After the disposal, X exercises a significant influence over operating and financial policies of Y.

The income statements for the year ended 30 November 2002 are as follows:

	X Ltd	Y Ltd	Z Ltd
	Shs. Million	Shs. Million	Shs. Million
Sales revenue	500	120	144
Cost of sales	<u>(120)</u>	<u>(48)</u>	<u>(48)</u>
Gross profit	380	72	96
Administrative expenses	(30)	(12)	(12)
Distribution costs	<u>(50)</u>	<u>(12)</u>	<u>(12)</u>
Profit before tax	300	48	72
Income taxes	<u>(100)</u>	<u>(12)</u>	<u>(24)</u>
Profit after tax	<u>200</u>	<u>36</u>	<u>48</u>
Accumulated profits on 1 December 2001	600	150	84

Further information:

- (i) The group policy is to amortize goodwill over its useful economic life of 5 years. It is company policy to charge a full year's amortization in the year of acquisition.
- (ii) X Ltd has not yet accounted for the sale of shares in Y Ltd. Ignore tax on profit on disposal.
- (iii) Z Ltd. sold goods worth Shs. 25 million to X Ltd. in the period following the acquisition, at cost plus 25%. A quarter of the goods were still held as part of inventory at 30 November 2002.
- (iv) Sales revenue and expenses accrue evenly on a time basis.

Required:

Prepare the Consolidated Income Statement for X Ltd. Group for the year ended 30 November 2002.

(20 marks)