

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

FINANCIAL REPORTING - PAPER 13

THURSDAY, 11 DECEMBER 2008

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Section **A** has **one** compulsory question carrying 30 marks.
3. Section **B** has **three** questions and only **two** questions are to be attempted. Each question carries 15 marks.
4. Section **C** has **three** questions and only **two** questions are to be attempted. Each question carries 20 marks.
5. Tables are provided on page 12.
6. Please, read further instructions on the answer book.

SECTION A: FINANCIAL REPORTING IN THE PRIVATE SECTOR**Question 1**

Biggs Ltd is a successful company that has a number of subsidiaries dealing in various goods and services. Biggs Ltd wants to enhance its operations in a number of areas by introducing the appropriate policies of accounting and finance.

- (a) The Finance Manager of Biggs Ltd has discovered that Gorilla Safaris Ltd, one of the subsidiaries, has significant cash flow problems. The directors and shareholders wish to take steps to improve the company's financial position. A proposal to issue a bond has been drafted in an attempt to improve the cash flow of the company.

The company proposes to issue a 5% bond with a face value of Shs 500 million on 1 January 2009 at a discount of 7% that will be secured on income from future gorilla tracking ticket sales and social events receipts, which are approximately Shs 200 million per annum. Under the agreement the company cannot use the first Shs 60 million received from social events and reserved gorilla tracking ticket sales because this will be used to repay the bond. The money from the bond will be used to pay for infrastructure improvements and to pay the wages of the guides.

The bond will be repayable, both capital and interest, over 15 years with the first payment of Shs 60 million due on 31 December 2009. It has an effective interest rate of 8%. There is no active market for bonds of this nature in the country and the company does not wish to use valuation models to value the bond.

Required:

Advise the directors of Biggs Ltd on the implications of a bond issue on the financial statements of Gorilla Safaris Ltd for the financial year ending 31 December 2009 setting out the account treatment and appropriateness in helping alleviate the company's cash flow problems.

(7 marks)

- (b) As part of its social responsibility campaign, Biggs Ltd allowed its 100% owned subsidiary to grant share appreciation rights (SARs) to its employees on 1 May 2006 based on ten million shares. The SARs provide employees, at the date the rights are exercisable, with the right to receive cash equal to the appreciation in the company's share price since the grant date. The rights vested on 30 April 2008 and payment was made on schedule on 1 June 2008. The fair value of the SARs per share at 30 April 2007 was Shs 240, at 30 April 2008 Shs 320 and at 1 June 2008 Shs 360.

The company recognised a liability for the SARs for the year ended 30 April 2007 as at that date, and for the year ended 30 April 2008 also as at that date based upon **IFRS 2: Share-based Payment**.

Required:

Advise the finance manager of Biggs Ltd on how the above transactions should be dealt with in the financial statements of the company.

(6 marks)

- (c) As part of financing its operations, Biggs Ltd sold some of the shares it held in G Ltd. G Ltd and S Ltd are among the numerous subsidiary companies of Biggs Ltd. No tax arose on the disposal of the shares. The income statements for Biggs Ltd and the two subsidiary companies for the year ended 31 December 2007 are given below:

	Biggs Ltd	S Ltd	G Ltd
	Shs '000	Shs '000	Shs '000
Profit before tax	50,000	40,000	15,000
Tax	<u>17,500</u>	<u>14,000</u>	<u>5,250</u>
Profit after tax	<u>32,500</u>	<u>26,000</u>	<u>9,750</u>

Biggs Ltd acquired its investments as follows:

	Equity %	Date	Cost	Issued capital	Reserves at acquisition	Goodwill on consolidation
			Shs '000	Shs '000	Shs '000	Shs '000
S. Ltd	80	2001	55,000	50,000	6,000	10,200
G. Ltd	60	2006	30,000	35,000	5,000	6,000

Biggs Ltd sold 5% of the shares in G Ltd on 30 June 2007 for Shs 6 million. Goodwill on consolidation has been fully written off. G Ltd's reserves at 1 January 2007 amounted to Shs 12.5 million.

Required:

Prepare a consolidated income statement for the Biggs Ltd group for the year ended 31 December 2007.

(6 marks)

- (d) The International Accounting Standards Board (IASB) replaced **IAS 1: Presentation of Financial Statements** (revised in 2003 and amended in 2005) with another revised version in 2007. The Finance Manager of Biggs Ltd is wondering about the changes that must be made in his financial statements.

Required:

(i) Give reasons for revising **IAS 1: Presentation of Financial Statements**.

(3 marks)

(ii) Enumerate some of the changes that were introduced in the current version.

(7 marks)

- (e) Biggs Ltd is assessing the valuation of its inventory. It has a significant quantity of a product in inventory and needs to evaluate its value for balance sheet purposes. Sales of the product are high, but it incurs high production costs. The reason for its success is that a sales commission of 20% of the list selling price is paid to the sales force. The product is collected from the warehouses of Biggs Ltd by the customers. The following details relate to this product;

	Shs per unit
List price	70,000
Allocation of customer discounts on selling price	3,500
Warehouse overheads until estimated sale date	5,600
Basic salaries of sales team	2,800
Cost of product	49,000

Required:

Discuss the accounting treatment of the above items in the financial statements for the year ended 31 December 2007

(4 marks)**(Total 30 marks)****SECTION B****Question 2**

Lutza Group of Companies (Lutza) recognised a gain of Shs 10 million on the translation of the financial statements for the year ended 31 December 2007 for one of the foreign subsidiaries in which Lutza owns 80%. The gain was on the translation of opening net assets as follows:

	Shs '000'
Non-current assets	5,625
Inventories	1,875
Receivables	3,125
Payables	(2,500)
Cash	<u>1,875</u>
	<u><u>10,000</u></u>

Lutza recognised a loss of Shs 4,375,000 on retranslating the parent entity's foreign currency loan. This loss was charged to consolidated reserves in the draft financial statements (given below) in accordance with **IAS 39: Financial Instruments: Recognition and Measurement**.

Consolidated Balance Sheets as at 31 December

	2007	2006
	Shs'000	Shs'000
Non-current assets	131,250	106,250
Inventories	40,625	30,000
Receivables	61,875	50,000
Cash	<u>31,250</u>	<u>10,000</u>
	<u>265,000</u>	<u>196,250</u>
Share capital	62,500	62,500
Consolidated reserves	<u>100,000</u>	<u>48,125</u>
	162,500	110,625
Minority interests	<u>32,500</u>	<u>23,125</u>
	195,000	133,750
Long-term loan	15,625	11,250
Payables	<u>54,375</u>	<u>51,250</u>
	<u>265,000</u>	<u>196,250</u>

Consolidated Income Statement for the year ended 31 December 2007

	Shs'000
Profit before tax (after depreciation of Shs 13,750,000)	135,625
Tax	<u>(40,625)</u>
Group profit after tax	<u>95,000</u>
Attributable to:	
Equity holders of Lutza	78,750
Minority interests	<u>16,250</u>
	<u>95,000</u>

Note:

There were no non-current asset disposals during the year. Dividends paid during the year were Shs 30.5 million.

Required:

Prepare Lutza's cash flow statement for the year ended 31 December 2007

(15 marks)

Question 3

- (a) Bale Ltd operates a factory near the border with a neighbouring country and their financial year ended on 31 January 2008. On 3 February 2008 a war broke out in the neighbouring country and there was a great influx of refugees fleeing from the war. The government of Bale Ltd's country requested the management of Bale Ltd to allow the refugees use the company's premises for shelter as arrangements were being made to relocate them far away from the border. Thereafter, during the asset valuation and verification exercise for finalisation of the financial statements, management discovered that one assembly line was no longer functioning due to a broken major component of one of the machines. Luckily enough the government agreed to compensate Bale Ltd for the loss, but the auditors wanted the asset to be written off in the financial statements for the year ended 31 January 2008. Because of the good news of compensation, the management proposed a final equity dividend for the year then ended.

Required:

- (i) Advise the Finance Manager of Bale Ltd about the treatment of the broken component.
(5 marks)
- (ii) Supposing Bale Ltd's management assessed the breakage plus the loss of production compared to the government's compensation and realised that it is better to liquidate Bale Ltd, how would you advise the finance manager?
(4 marks)
- (b) You are the senior auditor for a new assignment to Mwitanzige Oil Limited, a company drilling for oil on the shores of Lake Albert in Western Uganda. During the review of the previous financial statements for the year ended 30 June 2007, a member of your team, an audit trainee noticed that there was no reference to environmental matters and yet a new law had recently been enacted that will require Mwitanzige Oil Limited to change one of its production processes in order to reduce on oil spillage. This will involve purchasing and installing a new plant that is more efficient than the current one in use. To comply with the law, the new plant must be operational by 30 June 2009. In the management accounts for the year under audit, your assistant has noticed that a provision of Shs 5 billion had been disclosed as a separate item in the notes to the income statement as a cost for the new plant. You receive a memorandum from the trainee expressing concern about lack of reference to environmental matters

anywhere in the published financial statements for the year ended 31 June 2007. As a result the trainee believes that the financial statements did not comply with the requirements of International Financial Reporting Standards and therefore must have been wrong and need to be restated.

Required:

Draft a reply to your audit trainee pointing to the suggestion that the financial statements for the year were wrong since they did not make any reference to environmental matters.

(6 marks)

(Total 15 marks)

Question 4

The credit crisis that has hit the giant companies in the United States of America and other parts of the world has put the Financial Accounting Standards Board under pressure to improve fair value accounting (mark-to market accounting) and the accounting and disclosure standards for off-balance sheet financing and work with other standard-setters toward international convergence.

The CEO of one of the banks in Uganda is worried about how the credit crisis is going to affect his business. He has heard about fair value accounting and off-balance sheet financing and has approached you for an explanation.

Required:

(a) Explain the following to the CEO:

- (i) Mark-to market accounting. **(3 marks)**
- (ii) Off-balance sheet financing. **(3 marks)**
- (iii) Common types of off-balance sheet financing. **(3 marks)**
- (iv) Reasons for off-balance sheet financing. **(3 marks)**

(b) Distinguish between off-balance sheet financing and window dressing.

(3 marks)

(Total 15 marks)

SECTION C: FINANCIAL REPORTING IN THE PUBLIC SECTOR**Question 5**

The Ministry of Lands has been requested by Public Accounts Committee to furnish them with information relating to the way they utilised proceeds from their net surplus for the 9 months ended 31 March 2008.

The following information was availed to assist the ministry to come up with an appropriation account.

List of balances for the Ministry of Lands for 9 months ended 31 March 2008:

	Shs	Shs
Transfers - Capital		3,707,560
Revenue		2,192,373
Salaries and wages	884,141	
Social contributions	90,170	
Cash and bank balances	30,000	
Sale of publications		31,000
Machinery and equipment	623,018	
Motor vehicles	823,000	
Furniture and fittings	891,910	
Transfer to other government units	48,810	
Payables		1,903,181
Receivables	2,769,315	
Domestic arrears paid in the year	65,100	
Utility and property expenses	793,159	
Professional services	364,479	
Maintenance - machinery	134,260	
Telecommunication charges	13,650	
Travel inland	88,913	
General expenses	22,167	
Travel abroad and training expenses	220,000	
Insurance costs	48,000	
Interest costs	78,888	
Borrowings		134,000
Reserves	-	20,866
	<u>7,988,980</u>	<u>7,988,980</u>

Required:

Prepare an appropriation statement for the 9 months ended 31 March 2008.

(20 marks)

Question 6

The accountant of Koba Municipal Council has just been recruited and is not well versed with preparing financial statements for the council and has approached you for assistance.

The details relating to the accounts for the 9 months' period ending 31 March 2008 are given below:

Trial balance for the 9 months ending 31 March 2008:

	Shs '000'	Shs '000'
Local Revenue		
Business licences		9,350
Property taxes		33,200
Other licences		3,330
Park fees		43,120
Rent and rates: Non-produced assets		22,145
Royalties		9,800
Registration of businesses		2,300
Government Grants		
Conditional grants to PHC: Non-wage		120,000
Conditional grants to NGO hospitals		85,000
Conditional transfer to road maintenance		175,000
Compensation for graduated taxes		58,000
Expenses		
Town Clerk's Office		
General staff salaries	30,000	
Contract staff salaries	2,250	
Medical expenses	1,000	
Consultancy services	87,500	
Telecommunications	7,100	
Fuel, lubricants and oils	8,840	
Maintenance: Vehicles	3,150	
Office Support Service		
IFMS recurrent costs	7,850	
Finance		
General staff salaries	16,200	
Pension for local governments	3,800	
Computer supplies and IT services	4,725	
Telecommunications	6,100	

	Shs '000'	Shs '000'
IFMS recurrent costs	8,120	
Property expenses	1,313	
Maintenance – civil works	2,780	
Statutory Boards		
District Contracts Committee		
Allowances	2,224	
Advertising and public relations	500	
Welfare and entertainment	1,500	
Printing and stationery	820	
Health		
Salaries	18,000	
Allowances	3,730	
Books, periodicals and newspapers	880	
Telecommunications	6,000	
Property expenses	9,901	
Maintenance - vehicles	4,760	
Education		
General staff salaries	40,000	
Allowances	21,200	
Electricity	1,225	
Fuel, lubricants and oils	9,730	
Assets		
Road construction machinery – book value	40,000	
Building and structures	375,211	
Cash and bank balances	28,311	
Advances - receivables	63,000	
Staff advances	43,200	
Motor vehicles at book value	60,000	
Liabilities		
PAYE – payable to URA		15,100
Reserves		
Revenue		44,575
Capital	-	300,000
Totals	<u>920,920</u>	<u>920,920</u>

Other information:

1. One of the tenderers for the council's property has not paid her premium for the last eight months. The amount involved is Shs 160 million and this figure was not captured in the accounts.
2. One of the councillors, the Secretary for Health, took an advance of Shs 10 million to carry out immunization campaigns in the municipality. The activity was not carried out and the councillor has since died. The Treasurer proposed to treat the amount as a bad debt.
3. The council is in court over wrongful dismissal of the Town Clerk. He is asking for Shs 50 million as compensation. The case has not been disposed of.
4. One councillor's car was involved in a fatal road accident and damaged beyond repair. The book value of the car was Shs 16 million and had cost Shs 40 million, two years ago. The Engineer has advised for boarding it off.
5. Included in the figure for receivables (advances) is an amount of Shs 25 million advanced to John Murembe to organise a workshop on adult literacy. The workshop was held but accountability had not yet been submitted as of 31 March 2008.
6. The Council depreciates its assets as follows:
 - Buildings 3%
 - Vehicles and machinery 25%
 - Furniture and fittings 12.5%

Required:

Prepare a statement of financial performance for Koba Municipal Council for the 9 months' period ending 31 March 2008.

(20 marks)

Question 7

The broad issues of corporate governance, performance reporting, and comparability of financial and non-financial performance information are becoming increasingly important to users of general purpose financial reports of government entities and most governments are in the their final stages of adopting generally accepted accounting practice and Public Sector Accounting Standards (IPSAS).

The Government of Uganda is one of the leading countries that went for early adoption of IPSAS and currently is in the process of streamlining its stores and fixed assets. They have come across the following concepts and request for your assistance in applying them.

- (a) "The net realisable value of inventories is the amount which will be realized from the disposal of inventories less all costs of marketing, selling and distribution".
- (b) Non-cash generating assets have to be reviewed for impairment only when there is an indication that carrying values of assets may not be recoverable.

Required:

- (i) List **five** principal situations in which net realisable value may be lower than cost. **(5 marks)**
 - (ii) List **five** circumstances which can trigger off the need for impairment review. **(5 marks)**
 - (c) In line with public sector accounting, explain the meaning and importance of the following concepts:
 - (i) Warrants. **(2 marks)**
 - (ii) Modified cash basis of accounting. **(4 marks)**
 - (iii) Vote accounting. **(2 marks)**
 - (iv) Commitment accounting. **(2 marks)**
- (Total 20 marks)**

Table 1: PVIF- Present Value of Shs 1 Due at the End of n Periods

Period	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	18%	20%
1	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877	0.870	0.862	0.847	0.833
2	0.890	0.873	0.857	0.842	0.826	0.812	0.797	0.783	0.769	0.756	0.743	0.718	0.694
3	0.840	0.816	0.794	0.772	0.751	0.731	0.712	0.693	0.675	0.658	0.641	0.609	0.579
4	0.792	0.763	0.735	0.708	0.683	0.659	0.636	0.613	0.592	0.572	0.552	0.516	0.482
5	0.747	0.713	0.681	0.650	0.621	0.593	0.567	0.543	0.519	0.497	0.476	0.437	0.402
6	0.705	0.666	0.630	0.596	0.564	0.535	0.507	0.480	0.456	0.432	0.410	0.370	0.335
7	0.665	0.623	0.583	0.547	0.513	0.482	0.452	0.425	0.400	0.376	0.354	0.314	0.279
8	0.627	0.582	0.540	0.502	0.467	0.434	0.404	0.376	0.351	0.327	0.305	0.266	0.233
9	0.592	0.544	0.500	0.460	0.424	0.391	0.361	0.333	0.308	0.284	0.263	0.225	0.194
10	0.558	0.508	0.463	0.422	0.386	0.352	0.322	0.295	0.270	0.247	0.227	0.191	0.162
11	0.527	0.475	0.429	0.388	0.350	0.317	0.287	0.261	0.237	0.215	0.195	0.162	0.135
12	0.497	0.444	0.397	0.356	0.319	0.286	0.257	0.231	0.208	0.187	0.168	0.137	0.112
13	0.469	0.415	0.368	0.326	0.290	0.258	0.229	0.204	0.182	0.163	0.145	0.116	0.093
14	0.442	0.388	0.340	0.299	0.263	0.232	0.205	0.181	0.160	0.141	0.125	0.099	0.078
15	0.417	0.362	0.315	0.275	0.239	0.209	0.183	0.160	0.140	0.123	0.108	0.084	0.065

TABLE 2: PVAF - Present Value of an Annuity of Shs 1 per Period for n Periods

Period	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	18%	20%
1	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877	0.870	0.862	0.847	0.833
2	1.833	1.808	1.783	1.759	1.736	1.713	1.690	1.668	1.647	1.626	1.605	1.566	1.528
3	2.673	2.624	2.577	2.531	2.487	2.444	2.402	2.361	2.322	2.283	2.246	2.174	2.106
4	3.465	3.387	3.312	3.240	3.170	3.102	3.037	2.974	2.914	2.855	2.798	2.690	2.589
5	4.212	4.100	3.993	3.890	3.791	3.696	3.605	3.517	3.433	3.352	3.274	3.127	2.991
6	4.917	4.767	4.623	4.486	4.355	4.231	4.111	3.998	3.889	3.784	3.685	3.498	3.326
7	5.582	5.389	5.206	5.033	4.868	4.712	4.564	4.423	4.288	4.160	4.039	3.812	3.605
8	6.210	5.971	5.747	5.535	5.335	5.146	4.968	4.799	4.639	4.487	4.344	4.078	3.837
9	6.802	6.515	6.247	5.995	5.759	5.537	5.328	5.132	4.946	4.772	4.607	4.303	4.031
10	7.360	7.024	6.710	6.418	6.145	5.889	5.650	5.426	5.216	5.019	4.833	4.494	4.192
11	7.887	7.499	7.139	6.805	6.495	6.207	5.938	5.687	5.453	5.234	5.029	4.656	4.327
12	8.384	7.943	7.536	7.161	6.814	6.492	6.194	5.918	5.660	5.421	5.197	4.793	4.439
13	8.853	8.358	7.904	7.487	7.103	6.750	6.424	6.122	5.842	5.583	5.342	4.910	4.533
14	9.295	8.745	8.244	7.786	7.367	6.982	6.628	6.302	6.002	5.724	5.468	5.008	4.611
15	9.712	9.108	8.559	8.061	7.606	7.191	6.811	6.462	6.142	5.847	5.575	5.092	4.675