

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

FINANCIAL REPORTING - PAPER 13

THURSDAY, 10 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. 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 11.
6. Please, read further instructions on the answer book.

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

Sengo Ltd is a multinational company operating in several sectors. The directors of Sengo Ltd have been informed that there are new requirements of International Financial Reporting Standards (IFRSs). As the changes are designed to improve financial reporting and international convergence, the directors are keen to tap into these benefits and have resolved to use the services of a professional accountant in order to comply fully with the new requirements. The directors need specific advice on the following issues.

- (a) On 1 June 2007, Sengo Ltd purchased an 80% equity controlling interest in Beta Ltd and Beta Ltd purchased a 60% equity controlling interest in Muko Ltd on 31 May 2008.

The following financial statements relate to the Sengo Ltd Group as at 31 May 2009:

	Sengo Ltd Shs million	Beta Ltd Shs million	Muko Ltd Shs million
Cost of investment in Beta Ltd	12,800		
Cost of investment in Muko Ltd		8,800	
Other net assets	<u>10,400</u>	<u>5,280</u>	<u>12,000</u>
	<u>23,200</u>	<u>14,080</u>	<u>12,000</u>
Equity shares	16,000	9,600	8,000
Retained earnings	<u>7,200</u>	<u>4,480</u>	<u>4,000</u>
	<u>23,2000</u>	<u>14,080</u>	<u>12,000</u>

Additional information:

- (i) The retained earnings were:

	Beta Ltd Shs million	Muko Ltd Shs million
1 June 2007	1,600	400
31 May 2008	5,200	1,280

- (ii) The fair value of the non-controlling interest (NCI), based on effective shareholdings, was:

	Beta Ltd Shs million	Muko Ltd Shs million
1 June 2007	3,200	7,560
31 May 2008	3,920	8,000

- (iii) Due to the global recession, the goodwill of Beta Ltd was impaired as at 31 May 2009 by Shs 1.6 billion. There was no impairment in prior years.

Required:

- (i) State whether Sengo Ltd has control over Muko Ltd and the nature of control, if any.

(2 marks)

- (ii) Using the introduced option of measuring NCI and consolidated goodwill, prepare a consolidated statement of financial position for the Sengo Ltd group as at 31 May 2009.

(10 marks)

- (b) In the year ended 31 May 2008, Muko Ltd planted crops that cost Shs 5 million. At the end of the following year, the crops were attacked by a disease thus resulting in no active market for the crops. Experts, however, expect the situation to clear in six months' time. Until such a time, nobody is willing to risk an infected crop.

The latest sale by a farmer of similar crops was six months ago at a price of Shs 3 million. That farmer is not sure which way the market has moved since then.

The farmers in the vicinity have an average value of Shs 3.9 million for crops of a similar size. Muko Ltd recently read in a local gazette that the average price of such crops was Shs 4.5 million.

Required:

Advise Muko Ltd on the principles to be followed in the valuation of the crops in order to comply with **IAS 41: Agriculture**.

(6 marks)

- (c) Beta Ltd, which is incorporated in Uganda, took a loan of US \$ 50,000 on 1 June 2008, for a specific project at an interest rate of 5%, payable annually. On 1 June 2008, the exchange rate between the currencies was Shs 1,800 per US \$ 1. The exchange rate, as at May 31, 2009, was Shs 2,200 per US \$ 1. The corresponding amount could have been borrowed by Beta Ltd in local currency at an interest rate of 11% per annum as on 1 June 2008.

Required:

Advise Beta Ltd on the accounting treatment of the borrowing costs in order to comply with **IAS 23: Borrowing Costs**, and **IAS 21: The Effects of Changes in Foreign Exchange Rates**.

(6 marks)

- (d) Sengo Ltd operates a defined benefit plan for its employees which has the following characteristics:

		Shs '000'
1 June 2008	Fair value of plan assets	20,000
1 June 2008	Net cumulative unrecognised actuarial gains	1,520
30 Nov. 2008	Benefits paid	5,000
30 Nov. 2008	Contributions received	9,800
31 May 2009	Fair value of plan assets	30,000
31 May 2009	Present value of defined benefit obligation	29,584
2008/2009	Actuarial losses on the obligation	120

The expected rate of return on plan assets on 1 June 2009 was 12%.

Required:

Using suitable computations, advise Sengo Ltd on the amounts of actuarial gains or losses to be recognized as profit or loss in accordance with the limits of the 10% corridor set out in **IAS 19: Employee Benefits**.

(6 marks)

(Total 30 marks)

SECTION B: FINANCIAL REPORTING IN THE PRIVATE SECTOR

Question 2

- (a) Explain the recognition and measurement criteria of a finance lease arrangement by a lessor, according to **IAS 17: Leases**.

(5 marks)

- (b) Crate Enterprises Uganda Ltd (CEUL) is a manufacturing company which also hires out some of its high-tech equipment on long-term operating lease arrangements. On the 1 June 2008, CEUL entered into a five year lease contract with Classic Mansions Ltd (CML), a construction company. The terms of the lease are that CML pays Shs 2.9 million on 1 June 2008 for the use of a high tonnage crane followed by four annual rentals of Shs 2.4 million payable on the contract anniversary. The crane cost CEUL Shs 32 million and has a useful life of 20 years with a scrap value of Shs 0.8 million.

Required:

Advise CEUL on the accounting treatment and reporting of the above lease contract and show extracts of CEUL's statements of comprehensive income and financial position as at the end of the first two years.

(10 marks)

(Total 15 marks)

Question 3

- (a) When certain conditions are met, companies are permitted to apply hedge accounting, which is a risk management technique designed to offset changes in fair value or cash flow.

Required:

Explain the circumstances under which the principles of hedge accounting in **IAS 39: Financial Instruments, Recognition and Measurement**, are permitted.

(4 marks)

- (b) Kuku Ltd incurred expenditure on the development and operationalisation of its own website for internal and external access. This website is also used to promote and advertise Kuku Ltd's products and services.

Required:

Describe the recognition criteria for the expenditure incurred on the development of the website and provide the appropriate accounting treatment for the same under **IAS 38: Intangible Assets**.

(11 marks)

(Total 15 marks)

Question 4

- (a) Examine the main changes introduced in the revised **IFRS 3: Business Combinations**, which affect the reporting of the following elements in financial statements:

- (i) Acquisition related expenses.
- (ii) Contingent consideration.
- (iii) Measurement of non-controlling interest and consolidated goodwill.

(8 marks)

- (b) Most financial statements are drawn up on a historic basis though sometimes modified to include the revaluation of some non-current assets.

Required:

Examine the deficiencies of historic-based financial reporting and the reasons why historic cost accounts still prevail despite the deficiencies.

(7 marks)

(Total 15 marks)

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

You are provided with the following consolidated statements of financial performance and financial position of a government reporting entity for the financial year ending 31 May 2009. The entity is responsible for the provision of a number of services to the general public, and its recurrent expenditure is mainly funded by taxes levied on the public.

Statement of financial performance:

	Shs '000'
Revenue:	
Taxes	1,226,000
Revenue from portfolio investments	<u>20,000</u>
Total revenue	1,246,000
Expenses:	
Wages, salaries and employee benefits	1,040,000
Supplies and consumables used	36,400
Depreciation	18,000
Foreign exchange loss (note iv)	1,600
Finance costs	16,000
Other expenses	<u>200</u>
Total expenses	<u>1,112,200</u>
Surplus for the period	<u><u>133,800</u></u>

Statement of financial position:

Year ending 31 May	2009	2008
	Shs '000'	Shs '000'
Assets:		
Current assets:		
Cash and cash equivalents	9,000	6,400
Receivables	76,000	48,000
Inventories	40,000	78,000
Portfolio investments	100,000	100,000
Non-current assets:		
Infrastructure, plant & equipment: cost	149,200	76,400
Depreciation	(58,000)	(42,400)
Net book value	<u>91,200</u>	<u>34,000</u>
Total assets	<u><u>316,200</u></u>	<u><u>266,400</u></u>

	2009		2008	
	Shs '000'	Shs '000'	Shs '000'	Shs '000'
Liabilities:				
Current liabilities				
Payables		10,000		75,600
Interest payable		9,200		4,000
Non-current liabilities:				
Long-term borrowings		<u>92,000</u>		<u>41,600</u>
Total liabilities		<u>111,200</u>		<u>121,200</u>
Net assets		<u>205,000</u>		<u>145,200</u>
Equity:				
Capital contributed by government		60,000		50,000
Accumulated surpluses/(deficits)		<u>145,000</u>		<u>95,200</u>
		<u>205,000</u>		<u>142,500</u>

Additional information:

- (i) During the period, the entity acquired property, plant and equipment at an aggregate cost of Shs 50 million of which Shs 36 million was acquired by means of finance leases. Cash payments of Shs 14 million were made to purchase property, plant and equipment.
- (ii) Plant with original cost of Shs 3.2 million and accumulated depreciation of Shs 2.4 million was sold for Shs 0.6 million. The resulting loss on disposal has been included in other expenses.
- (iii) Receivables as at the end of May 2009 include Shs 4 million of interest receivable.
- (iv) Due to depreciation of the local currency, the entity suffered an exchange loss arising from cash balances held in foreign currency at the beginning of the year.
- (v) Although the entity is not a profit oriented one, it is expected to operate at a high level of efficiency and effectiveness in serving the public and pursuit of social policy objectives. Government subscribes for the entity's capital and indemnifies the entity when the capital is eroded. On the other hand when the entity makes a surplus, it is required to transfer part of the surplus as dividends to the consolidated fund.
- (vi) At the beginning of the financial year 2008/2009, management decided to takeover DO-IT Enterprise which is involved in the delivery of essential services to the community. The company also generates significant cash flows. All the shares of DO-IT Enterprise were acquired for Shs 23.6 million. Given that this was an unusual capital expenditure, the

government, in accordance with the provisions governing expenditure of a capital nature, had to release Shs 10 million as capital contribution for the acquisition while a further Shs 10 million was raised from long-term borrowings. The fair value of assets acquired and liabilities assumed were as follows:

	Shs '000'
Inventories	4,000
Receivable	4,000
Cash	1,600
Property, plant and equipment	26,000
Payables	4,000
Long term debt	8,000

Required:

For the year ending 31 May 2009, prepare a statement of cash flows for the entity using the indirect method in accordance with **IPSAS 2: Cash Flow Statements**.

(20 marks)

Question 6

- (a) Critically examine the application of the principles of **IPSAS 19: Provisions, Contingent Liabilities and Contingent Assets**, to the following facts and circumstances:
- (i) A government stores agency operates as a centralized purchasing agency and allows the public to purchase surplus supplies. It has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.
(3 marks)
 - (ii) During the financial year ending 30 June 2007, a provincial government gave a guarantee of certain borrowings of a private sector operator providing public services for a fee, whose financial condition at that time was sound. During 2007/2008, the financial condition of the operator deteriorated and on 30 June 2008 the operator filed for protection from its creditors.
(3 marks)
 - (iii) A hospital laundry operates from a building that the hospital (the reporting entity) has leased under an operating lease. During the year ended June 2008 the laundry relocated to a new building. The lease on the old building continues for the next four years: it cannot

be canceled. The hospital has no alternative use for the building and the building cannot be re-let to another user.

(2 marks)

- (iv) The Government of Uganda decides to reform the tax system. As a result of these changes, the Uganda Revenue Authority will need to retrain a large proportion of its administrative and compliance staff in order to ensure continued compliance with financial services regulation. At the reporting date, no retraining of staff has taken place.

(2 marks)

- (b) A government operates a gravel quarry on land that it leased on a commercial basis from a private individual on 1 June 2008. The gravel is used for the construction and maintenance of roads. The government paid Shs 25 million for a three year rent of the land. The agreement with the landowner requires the government to restore the quarry site by removing all buildings, reshaping the land and replacing all top soil; this is expected to cost the government Shs 15 million on 1 June 2011. Assuming a cost of capital of 12%.

Required:

Prepare extracts of financial statements that show the treatment of the above transaction over the 3-year period according to IPSAS 19.

(10 marks)

(Total 20 marks)

Question 7

Public sector entities derive revenues from exchange or non-exchange transactions. Revenue from exchange transactions is derived from:

- sale of goods or provision of services to third parties;
- sale of goods or provision of services to other government agencies; and
- the use by others of entity's assets yielding interest, royalties and dividends.

Required:

Explain the principles set out in **IPSAS 9: Revenue from Exchange Transactions**, regarding the recognition of revenue by government in respect of the following:

- (a) Sale of Goods:
- (i) "Bill and hold" sales, in which delivery is delayed at the purchaser's request but the purchaser takes title and accepts billing.
 - (ii) Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to

repurchase, or the purchaser has a put option to require the repurchase, by the seller, of the goods.

- (iii) Installment sales, under which the consideration is receivable in installments.

(10 marks)

- (b) On 31 December 2007, a government reporting entity purchased a 5 year bond carrying 4.7% interest paid annually. The bond has a par value of Shs 25 million but was purchased at a total cost of Shs 20 million and an implicit rate of 10%.

Required:

Show how the bond will be recognized and reported by the entity over the 5 years in order to comply with IPSAS 9.

(10 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