

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA(U) EXAMINATIONS

### LEVEL THREE

#### FINANCIAL REPORTING - PAPER 13

**TUESDAY, 14 JUNE 2011**

#### 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, before attempting any question.

## SECTION A: FINANCIAL REPORTING IN THE PRIVATE SECTOR

### Question 1

Kingfisher Ltd is a multinational company with diverse product ranges and operating in many geographical markets. Kingfisher Ltd is finalising its financial statements for the year ended 31 May 2011 and seeks your advice on the matters listed below:

- (a) On 1 January 2011 Kingfisher Ltd entered into a foreign currency forward contract with a local bank to purchase US\$ 100,000 for Shs 200 million on 31 December 2011. The auditors of Kingfisher Ltd have informed the company that this contract gave rise to a financial instrument which is a derivative instrument. Kingfisher Ltd was of the view that since it had paid nothing for the instrument on 1 January 2011, there was no need of recognising this instrument in the financial statements on that date or on 31 May 2011, the reporting date. In addition, Kingfisher Ltd has not come across a derivative instrument before and wishes to know what its characteristics are.

The forward foreign exchange rate on 31 May 2011 for forward purchase of US Dollar is US\$1 = Shs 2,400.

#### Required:

Explain to the management of Kingfisher Ltd:

- (i) what is meant by a derivative instrument. **(3 marks)**
- (ii) how a foreign currency forward contract works and the accounting requirements for the treatment of the foreign currency contract in the financial statements. **(2 marks)**
- (iii) the effect of the foreign currency forward contract in the financial statements of Kingfisher Ltd for the year ended 31 May 2011. **(3 marks)**
- (b) Kingfisher Ltd has a foreign subsidiary in USA, Jones Ltd, whose functional currency is US\$. Jones Ltd owns a financial asset which is classified at fair value through profit or loss. Jones Ltd had acquired the financial asset at the cost of US\$ 150,000 on 1 March 2011 when the exchange rate was US\$1 = Shs 2,300.

On 31 May 2011, the fair value of financial asset was US\$ 180,000 and the exchange rate was US\$1 = Shs 2,400. The finance director of Kingfisher Ltd was worried as to how this financial asset would be accounted for in the financial statements of Jones Ltd and in the consolidated financial statements.

The average exchange rate for the period 1 March 2011 to 31 May 2011 was US\$1 = Shillings 2,350.

**Required:**

Explain to Kingfisher Ltd:

- (i) how the financial asset owned by a foreign subsidiary and classified at fair value through profit or loss should be accounted for in the financial statements of the subsidiary and the consolidated financial statements.  
(5 marks)
- (ii) the effect of the above financial asset in the financial statements of Jones Ltd and consolidated financial statements of Kingfisher Ltd.  
(3 marks)
- (c) On 1 June 2010, Kingfisher Ltd acquired a newly constructed oil platform at a cost of Shs 30 billion together with the right to extract oil from an offshore oilfield under a government licence. The terms of the licence are that in 10 years' time when the oil reserves have been exhausted, Kingfisher Ltd will have to remove the platform (which will then have no value) and restore the lake bed to an environmentally satisfactory condition. The estimated cost of this exercise on 31 May 2020 will be Shs 15 billion. The present value of Shs 100 receivable in 10 years at the appropriate discount rate for Kingfisher Ltd of 8% is Shs 46.

**Required:**

- (i) Explain and quantify how the oil platform should be treated in the financial statements of Kingfisher Ltd for the year ended 31 May 2011.  
(5 marks)
- (ii) Describe how your answer in (c) (ii) above would change if the government licence did not require environmental clean up.  
(3 marks)
- (d) Kingfisher Ltd is reviewing the accounting treatment of its buildings. The company uses the 'revaluation model' for its buildings. The buildings had originally cost Shs 1 billion on 1 June 2009 and had a useful economic life of 20 years. The buildings are being depreciated on a straight line basis to a nil residual value. The buildings were revalued downwards on 31 May 2010 to Shs 800 million which was the buildings' recoverable amount. At 31 May 2011, the value of the buildings had risen to Shs 1.1 billion which is to be included in the financial statements.

**Required:**

Explain the effect of the revaluation on 31 May 2011 in the financial statements of Kingfisher Ltd for the year ended 31 May 2011.

**(6 marks)****(Total 30 marks)****SECTION B: FINANCIAL REPORTING IN THE PRIVATE SECTOR****Question 2**

The following draft statements of financial position relate to Sure Ltd, Nabasa Ltd and Tamina Ltd as at 31 May 2011.

|                             | Sure Ltd<br>Shs billion | Nabasa Ltd<br>Shs billion | Tamina Ltd<br>Shs billion |
|-----------------------------|-------------------------|---------------------------|---------------------------|
| <b>Assets</b>               |                         |                           |                           |
| Non-current assets:         |                         |                           |                           |
| Tangible non-current assets | 1,500                   | 500                       | <u>300</u>                |
| Investment in Nabasa        | 750                     |                           |                           |
| Investment in Tamina        | <u>190</u>              | <u>100</u>                |                           |
|                             | <u>2,440</u>            | <u>600</u>                | <u>300</u>                |
| Current Assets:             |                         |                           |                           |
| Inventory                   | 375                     | 125                       | 80                        |
| Trade receivables           | 300                     | 105                       | 50                        |
| Cash at bank and in hand    | <u>90</u>               | <u>50</u>                 | <u>75</u>                 |
|                             | <u>765</u>              | <u>280</u>                | <u>205</u>                |
| Total Assets                | <u>3,205</u>            | <u>880</u>                | <u>505</u>                |
| Capital and reserves        |                         |                           |                           |
| Called up share capital     | 1,800                   | 400                       | 200                       |
| Share premium               | 300                     | 100                       | 50                        |
| Retained earnings           | <u>800</u>              | <u>200</u>                | <u>105</u>                |
|                             | 2,900                   | 700                       | 355                       |
| Non-current liabilities     | 100                     | 50                        | 25                        |
| Current liabilities         | <u>205</u>              | <u>130</u>                | <u>125</u>                |
|                             | <u>3,205</u>            | <u>880</u>                | <u>505</u>                |

Additional information:

- (i) Sure Ltd acquired eighty percent of the ordinary share capital of Nabasa Ltd on 1 June 2008 when the retained earnings of Nabasa Ltd were Shs 100 billion. The fair value of the net assets of Nabasa Ltd was the same as its carrying amount at the date of acquisition. Sure Ltd uses the 'full goodwill' method to measure the non-controlling interests at the date of acquisition. The fair value of the non-controlling interests in Nabasa Ltd was Shs 150 billion on 1 June 2008.

- (ii) Sure Ltd and Nabasa Ltd acquired 40% and 25% respectively of the ordinary share capital of Tamina Ltd on 1 June 2009 when the retained earnings of Tamina Ltd were Shs 50 billion and those of Nabasa Ltd were Shs 150 billion. The fair value of the net assets of Tamina Ltd was the same as its carrying amount at the date of acquisition. The fair value of the non-controlling interest in Tamina Ltd was Shs 125 billion.

**Required:**

Prepare a consolidated statement of financial position for the Sure Group on 31 May 2011 in accordance with the International Financial Reporting Standards.

**(15 marks)**

**Question 3**

Kasoni Limited has met the definition of small and medium-sized entities (SME) as per the guidelines issued by the Institute of Certified Public Accountants of Uganda and wishes to comply with the International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities'. The entity wishes to seek advice on how it will deal with the following items in its financial statements. Kasoni Limited already prepares its financial statements under full IFRS. The entity is also seeking advice on how it will achieve transition from full IFRSs to IFRS for SMEs.

- (i) Research and Development Expenditure.
- (ii) Interest in a newly acquired subsidiary which is also an SME. Kasoni Limited has used the full goodwill method to account for business combinations.
- (iii) Defined Benefit Schemes. Kasoni Limited currently uses the 'corridor approach' to recognise actuarial gains and losses.
- (iv) Kasoni Ltd currently uses the equity method to account for its investments in associates.
- (v) Kasoni Ltd currently uses the revaluation model to measure its property, plant and equipment.

**Required:**

- (a) Discuss how the above items should initially and subsequently be measured in the financial statements of Kasoni Ltd, with reference to the IFRS for SMEs.

**(10 marks)**

- (b) Advise Kasoni Ltd as to how it will achieve the transition from full IFRSs to IFRS for SMEs.

**(5 marks)**

**(Total 15 marks)**

**Question 4**

Kiboko, a limited company, is a multinational and diversified company. The draft consolidated financial statements for Kiboko Group are as follows:

Draft statement of financial position as at 31 May 2011

|                                 | 2011          | 2010          |
|---------------------------------|---------------|---------------|
|                                 | Shs million   | Shs million   |
| <b>Assets</b>                   |               |               |
| Non-current assets:             |               |               |
| Property, plant and equipment   | 4,500         | 3,000         |
| Investments in associates       | 1,400         | 1,300         |
| Investments                     | <u>1100</u>   | <u>1100</u>   |
|                                 | <u>7,000</u>  | <u>5,400</u>  |
| Current assets:                 |               |               |
| Inventories                     | 2,500         | 1,800         |
| Trade receivables               | 2,300         | 1,500         |
| Cash                            | <u>4,200</u>  | <u>1,700</u>  |
|                                 | <u>9,000</u>  | <u>5,000</u>  |
|                                 | <u>16,000</u> | <u>10,400</u> |
| <b>Equity and liabilities</b>   |               |               |
| Issued share capital            | 4,000         | 3,000         |
| Share premium                   | 2,775         | 1,340         |
| Accumulated profits             | 4,150         | 2,900         |
| Non-controlling interests       | <u>175</u>    | <u>-</u>      |
|                                 | <u>11,100</u> | <u>7,240</u>  |
| Non-current liabilities:        |               |               |
| Obligation under finance leases | 900           | 200           |
| Loans                           | 1,800         | 1,700         |
| Deferred taxation               | <u>100</u>    | <u>60</u>     |
|                                 | <u>2,800</u>  | <u>1,960</u>  |
| Current liabilities:            |               |               |
| Trade payables                  | 750           | 300           |
| Obligation under finance leases | 250           | 220           |
| Income tax                      | 600           | 400           |
| Proposed dividends              | 400           | 200           |
| Accrued interest                | <u>100</u>    | <u>80</u>     |
|                                 | <u>2100</u>   | <u>1200</u>   |
|                                 | <u>16,000</u> | <u>10,400</u> |

Draft consolidated income statement for the year ended 31 May 2011:

|   | Shs million    |
|---|----------------|
| Revenue   | 4,500          |
| Cost of sales   | <u>(1,500)</u> |
| Gross profit  | 3,000          |
| Operating expenses  | (775)          |
| Share of profits of associates  | 750            |
| Income from investments   | 240            |
| Impairment loss (goodwill)  | (150)          |
| Interest expense  | <u>(225)</u>   |
| Profit before tax   | 2,840          |
| Income tax expense (tax attributable to income of associates was Shs 225 million) | <u>(840)</u>   |
| Net profit  | <u>2,000</u>   |
| Attributable to:  |                |
| Equity shareholders of parent   | 1,850          |
| Non-controlling interests   | <u>150</u>     |
|   | <u>2,000</u>   |

Additional information:

1. Property, plant and equipment depreciation charge for the year was Shs 600 million.
2. Machinery costing Shs 500 million was sold for Shs 500 million resulting in a profit of Shs 100 million.
3. New machinery was acquired in 2011 under finance leases, including additions of Shs 1,200 million.
4. On 1 June 2010, Kiboko Ltd acquired 75% interest in Nkane Ltd. Information relating to the acquisition of Nkane Ltd is as follows:

|   | Shs million |
|---|-------------|
| Property, plant and equipment   | 180         |
| Inventories   | 50          |
| Trade receivables   | 40          |
| Cash  | 120         |
| Less:   |             |
| Trade payables  | (700)       |
| Income tax  | <u>(20)</u> |
|   | 300         |
| Less: Non-controlling interests share at the proportionate share of identifiable net assets | <u>(75)</u> |
|   | 225         |

|                    |             |
|--------------------|-------------|
|                    | Shs million |
| Goodwill           | <u>150</u>  |
| Consideration paid | <u>375</u>  |
| Settled by:        |             |
| Issue of shares    | 350         |
| cash payment       | <u>25</u>   |
|                    | <u>375</u>  |

By 31 May 2011, goodwill was fully impaired.

5. During the year ended 31 May 2011, Kiboko Ltd issued new ordinary shares for a cash consideration of Shs 2,085 million.
6. Dividends paid and proposed for the year ended 31 May 2011 were Shs 600 million.

**Required:**

Prepare a consolidated statement of cash flows for the Kiboko Group for the year ended 31 May 2011.

**(15 marks)**

## SECTION C: FINANCIAL REPORTING IN THE PUBLIC SECTOR

### Question 5

Construction contracts are formulated in a number of ways which, for the purposes of IPSAS 11: Construction Contracts, are classified as fixed price contracts and cost plus or cost based contracts. Some commercial construction contracts may contain characteristics of both a fixed price contract and a cost plus or cost based contract, for example in the case of a cost plus or cost based contract with an agreed maximum price.

**Required:**

- (a) Explain what you understand by:
  - (i) fixed price contracts.
  - (ii) cost-based contracts.

**(5 marks)**

- (b) In each of the above cases, show the requisite circumstances, a contractor needs to consider in order to determine when to recognize contract revenue and expenses.

**(6 marks)**



- (c) A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel, but may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use for example water supply systems.

**Required:**

- (i) Explain the requirements when a contract covers a number of assets; the circumstances for the construction of each asset to be treated as a separate construction contract:
- (ii) The requirements for a group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract:

**(9 marks)**

**(Total 20 marks)**

**Question 6**

A government that prepares and presents consolidated financial statements under the accrual basis of accounting and elects to disclose financial information about the general government sector shall do so in accordance with the requirements of this Standard - International Public Sector Accounting Standard (IPSAS) 22: Disclosure of Financial Information about the General Government Sector.

**Required:**

- (a) Explain the term 'general government sector'.
- (b) Describe the characteristics of a general government business.
- (c) Give the disclosures made in respect of the general government sector

**(2 marks)**

**(8 marks)**

**(10 marks)**

**(Total 20 marks)**

**Question 7**

- (a) International Public Sector Accounting Standard (IPSAS) 23: Revenue from Non-exchange Transactions (taxes and transfers) prescribes requirements for the financial reporting of revenue arising from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination.

**Required:**

Explain the terms:

- (i) Non-exchange transactions.
- (ii) Exchange transactions.

**(4 marks)**

- (b) An entity received Shs 6 billion funding from a multi-lateral development agency to build ten schools in Uganda over the next 5 years. The funding is provided on following conditions:
- Shs 1 billion of the funding need not be repaid, provided schools are built
  - Shs 5 billion of the funding is to be repaid as follows;
    - Year 1: no capital to be repaid
    - Year 2: 10% of the capital to be repaid
    - Year 3: 20% of the capital to be repaid
    - Year 4: 30% of the capital to be repaid
    - Year 5: 40% of the capital to be repaid
  - Interest is charged at 5% per annum over the period of the loan- assuming interest is paid annually in arrears. The market rate of interest for a similar loan is 10%
  - To the extent that schools have not been built, the funding provided should be returned to the donor (assume that the donor has effective monitoring systems in place and has a past history of requiring any unspent funds to be returned)
  - The entity built the following schools over the period of the loan
    - Year 1: 1 School completed
    - Year 2: 3 Schools completed
    - Year 3: 5 Schools completed
    - Year 4: 10 Schools completed
  - Assuming Shs 1 billion is revenue.

**Required:**

Illustrate how the entity will recognize and treat revenue arising from the concessional loan assuming the entity takes Shs 1 billion as revenue.

- (i) On initial recognition.
- (ii) Year 1.
- (iii) Year 2.
- (iv) Year 3.
- (v) Year 4.

**(16 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 |