

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

ATC(U) EXAMINATIONS

LEVEL THREE

INTRODUCTION TO FINANCIAL REPORTING – PAPER 12

THURSDAY, 16 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. Attempt **all** the questions in Section **A**, any **two** questions in Section **B** and any **two** questions in Section **C**.
3. Section **A** has **one** compulsory question carrying 20 marks.
4. Section **B** has **three** questions and only **two** are to be attempted. Each question carries 20 marks.
5. Section **C** has **three** questions and only **two** are to be attempted. Each question carries 20 marks.
6. Please read further instructions on the answer booklet.

SECTION A**Question 1**

The following is a list of account balances extracted from the books of Brown Co. Ltd for the year ended 31 May 2011.

	Shs '000'
Trade payables	39,800
Sales revenue	500,000
Land at cost	206,400
Buildings at cost	240,000
Furniture and fittings at cost	140,000
Bank overdraft	49,100
Provision for depreciation 1 June 2010	
- Buildings	36,000
- Furniture and fittings	60,000
Discount received	12,400
Retained profits 1 June 2010	12,000
Provision for doubtful debts	5,196
Cash in hand	1,424
Inventory at 1 June 2010	91,788
Interim dividend on preference shares	3,900
Rates	15,000
Wages and salaries	50,000
Insurance	12,500
Returns inwards	2,732
General expenses	3,120
Debenture interest	4,800
Bad debts written off	4,056
10% debentures	96,000
6% Shs 1,000 preference shares	130,000
Shs 1,000 ordinary shares	130,000
Non-current assets replacement reserve	60,000
Share premium account	6,000
Purchases	264,636
Trade receivables	96,140

Additional information:

- (i) Inventory at 31 May 2011 was Shs 95,500,000.
- (ii) Insurance has been prepaid by Shs 700,000 at 31 May 2011.
- (iii) There were wages owing to staff of Shs 1,900,000 at 31 May 2011.
- (iv) Depreciation is to be provided at 10% of the cost of buildings and at 20% of the written down value of furniture and fittings.

- (v) Debenture interest outstanding at 31 May 2011 is Shs 4,800,000.
- (vi) Provision for doubtful debts is to be reduced to 5% of trade receivables.
- (vii) The directors propose to pay the final preference dividend and to pay dividends of 12% on ordinary shares.
- (viii) The directors proposed to transfer Shs 30 million to the non-current assets replacement reserve.
- (x) The corporation tax charge for the year is Shs 40 million and should be provided for.

Required:

Prepare, the following financial statements for the year ended 31 May 2011 for Brown Co, Ltd, as far as possible, in accordance with IAS 1: Presentation of Financial Statements.

- (a) Statement of comprehensive income. **(11 marks)**
 - (b) Statement of changes in equality. **(9 marks)**
- (Total 20 marks)**

SECTION B

Question 2

The objective of IAS 16: Property, Plant and Equipment is to prescribe the accounting treatment for property, plant and equipment. More importantly, it involves distinguishing between capital and revenue expenditure, measuring the cost of assets, determining how they should be depreciated and subsequent measurement and expenditure.

Required:

- (a) Explain the circumstances under which subsequent expenditure on those assets should be capitalized. **(8 marks)**
- (b) Chalk Ltd received a quotation for an item of equipment with the following details;

	Shs '000
Price list of equipment	3,750,000
Auxiliary costs:	
Shipping and handling	43,000
Pre-production testing	200,000
Maintenance (contract for 3 years)	400,000
Installation costs:	
Electrical installation	250,000
Materials for foundation construction	75,000
Architect's fees	125,000

The electrical installation was faulty thereby necessitating correction costs of Shs 60 million. This cost is included in the electrical installation cost of

Shs 250 million above. The equipment has an estimated economic useful life of 10 years after which there will be compulsory costs of dismantling of Shs 200 million.

Required:

Calculate the amount at which the equipment should be measured at recognition.

(10 marks)

- (c) Briefly explain what is meant by appreciation.

(2 marks)

(Total 20 marks)

Question 3

Gravel Extractors Ltd acquired the rights to remove gravel deposits from land owned by Taka Ltd. The agreement provided for:

- (a) The payment of a royalty of Shs 4,000 per tonne of gravel removed.
- (b) A minimum payment of Shs 20 million per annum.
- (c) Recoupment rights (for short workings) to be extinguished at the end of year 3.

During the first four years of the contract, the following quantities of gravel were removed.

Year	Tonnes
1	4,000
2	4,800
3	5,400
4	5,600

The company's accounting year ends on 31 December and payment to Taka Ltd is made on 1 February following:

Required:

Prepare the following accounts in Gravel Extractor Ltd's ledgers for each of the four years:

- (i) Royalties payable account. **(5 marks)**
- (ii) Taka Ltd's account. **(10 marks)**
- (iii) Short workings recoverable. **(5 marks)**

(Total 20 marks)

Question 4

Write short notes on the following techniques as applied in public sector accounting:

- (a) Budgetary accounting. (4 marks)
- (b) Fund accounting. (4 marks)
- (c) Cash accounting. (4 marks)
- (d) Accruals accounting. (4 marks)
- (e) Commitment accounting. (4 marks)

Total 20 marks

SECTION C

Question 5

The preparation of financial statements always involves the consideration of events which have or will occur after the reporting date because at the reporting date there are numerous transactions in progress where the outcome is uncertain. The auditor should perform procedures designed to obtain sufficient appropriate audit evidence that: all material subsequent events up to the date of their report, which require adjustment of the financial statements have been identified and incorporated in the accounts.

Required:

- (a) State any **five** procedures that the auditor performs to identify material subsequent events. (10 marks)
- (b) Outline the general enquiries that the auditor may make regarding the financial statements after the date of their report. (10 marks)

(Total 20 marks)

Question 6

Auditors should document in their working papers matters which are important in supporting their report.

Required:

- (a) Briefly explain what the auditors' working papers should consist of. (10 marks)
- (b) Outline **ten** contents of the current audit file. (10 marks)

(Total 20 marks)

Question 7

In recent years, business enterprises have gone into bankruptcy, receivership or liquidation. The reasons given for their failure are many. There have been many instances when a company has issued financial statements prepared on the going concern basis, having an unqualified auditor's report and then go bust shortly afterwards.

Required:

Outline **ten** financial indicators the auditor will use to question the appropriateness of the going concern assumption.

(20 marks)