

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

FINANCIAL REPORTING - PAPER 13

FRIDAY, 30 NOVEMBER 2012

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 13.
6. Write your answer to each question on a fresh page in your answer booklet.
7. Please, read further instructions on the answer booklet, before attempting any question.

SECTION A: FINANCIAL REPORTING IN THE PRIVATE SECTOR

This section contains on compulsory case study question.

Question 1

- (a) On 1 January 2012, Papagiant Ltd purchased 120 million equity shares in Soniya Ltd. Soniya Ltd's ordinary share capital is comprised of 160 million shares of Shs 300 per share. The summarised statements of comprehensive income for the two companies for the year ended 30 June 2012 are as follows:

	Papagiant Ltd Shs million	Soniya Ltd Shs million
Revenue	135,000	72,000
Cost of sales	<u>(78,000)</u>	<u>(33,000)</u>
Gross profit	57,000	39,000
Distribution costs	(7,080)	(600)
Administration expenses	(8,100)	(6,900)
Finance costs	<u>(450)</u>	<u>(360)</u>
Profit before tax	41,370	31,140
Income tax expense	<u>(12,411)</u>	<u>(9,342)</u>
Profit for the year	<u>28,959</u>	<u>21,798</u>

Additional information:

- (i) After acquisition on 1 January 2012, Papagiant Ltd transferred an item of plant with a carrying amount of Shs 1,200 million to Soniya Ltd at Shs 1,500 million. The plant had a remaining life of two and half years. Papagiant Ltd had included the profit on this transfer as a reduction in its depreciation costs. All depreciation is charged to administration expenses. Papagiant Ltd Group depreciates such plants on straight line basis.
- (ii) After the acquisition, Soniya Ltd sold goods to Papagiant Ltd for Shs 12,000 million. These goods had cost Soniya Ltd Shs 9,000 million. Shs 3,600 million of the goods sold remained in Papagiant Ltd's closing inventory.
- (iii) On 1 October 2011, Papagiant Ltd acquired 40% of the equity capital of Socialite Ltd. No dividends have so far been received by Papagiant Ltd from Socialite Ltd but extracts from Socialite Ltd's income statement for the year ended 30 June 2012 show the following results which have not yet been reflected in Papagiant Ltd's statement of comprehensive income:

	Shs million
Profit before tax	18,000
Tax	<u>(6,000)</u>
Profit after tax	<u>12,000</u>

- (iv) Goodwill arising from acquisition has not suffered any impairment.
- (v) All items in the statements of comprehensive income above are deemed to accrue evenly.

Required:

Prepare a consolidated statement of comprehensive income of Papagiant Ltd Group for the year ended 30 June 2012.

(15 marks)

- (b) Alkenes Ltd is incorporated in Uganda with a network of branches across the country as well as subsidiaries in the region. The company is preparing its final accounts for the year ended 30 June 2012 and is seeking guidance from a qualified accountant on the treatment of the following issues in order to comply with International Financial Reporting Standards (IFRS):

- (i) Alkenes Ltd set up a foreign subsidiary in South Africa on 1 January 2012. Alkenes Ltd subscribed 100,000 rand when the exchange rate was Shs 300 = R1. On that date, the subsidiary, Juniya Ltd borrowed R 300,000 and bought a non-monetary asset for R 400,000. At the time of Alkenes Ltd's preparation of financial statements on 30 June 2012, the exchange rate had moved to Shs 400 = R1.

Required:

Account for the above transactions in both the functional currency of Juniya Ltd and the reporting currency of Alkenes Ltd.

(6 marks)

- (ii) Alkenes Ltd on 1 July 2011 sold a property under a twenty year lease to Pangisa Ltd. The consideration for the lease was Shs 11,250 million. Alkenes Ltd has signed an unconditional agreement to repurchase the lease of the property after four years for a fixed amount of Shs 13,750 million. By comparing the value of the property and the consideration received, Alkenes Ltd has reported a profit of Shs 1,250 million and the property removed from Alkenes Ltd's statement of financial position.

Depreciation policy on such property is 5% per annum on the carrying value of the asset and the effective interest rate in the lease is 5.14%.

Required:

Discuss the suitability of the above approach in relation to 'substance over form' and advise Alkenes Ltd on the appropriate treatment.

(5 marks)

- (iii) In August 2012, before the Alkenes Ltd's financial statements were authorized for issue, the following events arose:

An insurance claim by Alkenes Ltd's for Shs 40 million was agreed on 14 August 2012 for compensation for a flood in December 2011 which damaged part of the inventory.

The directors declared a dividend of Shs 150 per ordinary share on 9 August 2012. Alkenes Ltd has 2 million ordinary Shs 1,000 shares in issue.

Inventory valued at Shs 85 million in the statement of financial position was sold for Shs 60 million.

A customer, with an outstanding balance of Shs 12 million was declared bankrupt.

Required:

Explain the accounting treatment of each of the above transactions.

(4 marks)

(Total 30 marks)

SECTION B: FINANCIAL REPORTING IN THE PRIVATE SECTOR

Attempt two of the three questions in this section.

Question 2

Alpha Uganda Ltd (AUL) is seeking advice from a professional accountant in relation to the reporting requirements of the following items for the year ending 30 June 2012:

- (a) On 1 July 2011, AUL issued 10,000 5% convertible bonds at their par value of Shs 125,000 each. The bonds will be redeemed on 1 July 2016. Each bond is convertible at the option of the holder at any time during the year period. Interest on the bond will be paid annually in arrears. The prevailing market interest for similar debt without conversion options at the date of issue was 6%.

Required:

With relevant computations, advise AUL on the treatment of the convertible bond in the financial statements at the date of issue.

(7 marks)

- (b) AUL has a retirement benefit scheme managed by a commercial bank. The manager of the retirement benefit scheme is also a non-executive director of Alpha and received an annual fee for his services of Shs 62.5 million which is not material in AUL's context. AUL pays Shs 40,000 million per annum into the scheme and occasionally transfers assets into the scheme. In the year ending 30 June 2012, plant and equipment of Shs 25,000 million were transferred into the scheme and a charge for administration costs of Shs 7,500 million was made.

Required:

Explain the related party disclosures required in respect of the above events.

(5 marks)

- (c) On 1 July 2011, AUL purchased equipment with a useful life of 10 years from an American supplier for \$100,000 when the exchange rate was \$1: Shs 2,000. The equipment was delivered and installed on 3 July 2011. AUL paid for the equipment in full on 1 June 2012 when the exchange rate was \$1: Shs 2,500.

Required:

Advise AUL on the accounting treatment of the equipment transaction for the year ending 30 June 2012 in order to comply with IFRS.

(3 marks)**(Total 15 marks)****Question 3**

- (a) (i) Explain the term 'goodwill' as used in acquisitions, clearly indicating its main characteristics. **(5 marks)**
- (ii) Elucidate the accounting treatment of goodwill arising out of business combinations in accordance with full IFRS. **(5 marks)**
- (b) Grandeur Ltd, whose year end is 30 June has a subsidiary, Mtoto Ltd which it acquired in stages. The share capital of Mtoto Ltd is one million shares of Shs 600 per share. The details of the acquisition are as follows:

Date of acquisition	Holding acquired %	Retained earnings at acquisition Shs '000'	Purchase consideration Shs '000'	Fair values per share Shs
1 July 2010	20	540,000	240,000	1,200
1 July 2011	60	900,000	960,000	1,600

The fair values of the net assets of Mtoto Ltd were the same as their carrying amounts on the dates of share purchase; Grandeur Ltd did not have significant influence over Mtoto Ltd before gaining control and Grandeur Ltd's policy is to measure non-controlling interest at its proportionate share of the fair value of the subsidiary's identifiable net assets.

Required:

Calculate the goodwill on the acquisition of Mtoto Ltd that will appear in Grandeur Ltd's consolidated statement of financial position at 30 June 2012.

(5 marks)**(Total 15 marks)**

Question 4

- (a) Examine the role of the International Accounting Standards Board's reporting framework for the preparation and presentation of financial statements. **(4 marks)**
- (b) Jewellery Ltd has the following financial instruments in its financial statements for the year ended 30 June 2012:
- (i) An investment in the debentures of Pearls Ltd, nominal value of Shs 80 million purchased on their issue on 1 July 2011 at a discount of Shs 12 million and carrying a 4% coupon. Jewellery Ltd plans to hold the debentures until their redemption on 30 June 2015. The internal rate of return of the debentures is 8.6%.
 - (ii) 100,000 redeemable preference shares issued in 2010 at Shs 2,000 per share with an annual dividend of Shs 120 per share redeemable in 2018 at their nominal value. Given that the preference shares are issued and redeemable at the same value, the effective rate and nominal coupon rate are presumed to be at the same value of 6%.

Required:

Advise Jewellery Ltd on the relevant accounting treatment of the above instruments in its financial statements for the year ended 30 June 2012.

(11 marks)
(Total 15 marks)

SECTION C: FINANCIAL REPORTING IN THE PUBLIC SECTOR

Attempt two of the three questions in this section.

Question 5

The following trial balance was extracted from the books of the Ministry of Information Technology for the period ended 30 June 2012:

Account code	Debit (Shs)	Credit (Shs)
133102 Transfers received from Treasury		1,399,853,120
133202 Transfers received from Treasury		136,949,620
141602 Sale of non-produced Government property		22,124,000
142104 Miscellaneous income		21,518,260
211101 General staff salaries	337,885,836	
211103 Allowances	173,236,711	
213001 Medical expenses (to employees)	6,148,983	
221001 Advertising and publications	66,162,986	
221002 Workshops and seminars	54,846,458	
221003 Staff training	10,755,446	
221004 Recruitment expenses	31,465,881	
221006 Commissions and related charges	88,215,944	
221008 Computer supplies and IT services	12,995,584	
221009 Welfare and entertainment	42,522,663	
221011 Printing, stationery	80,107,724	
221012 Small office equipment	3,987,326	
221016 IFMS recurrent cost	7,283,860	
221017 Subscriptions	11,581,169	
222001 Communication	21,538,268	
223001 Property expenses	4,192,011	
223003 Guarding and security services	14,940,733	
223005 Electricity	14,007,196	
223006 Water	3,088,850	
224002 General goods and services	65,703,135	
225001 Consultancy	47,215,267	
227001 Travel inland	135,999,651	
227002 Travel abroad	34,011,907	
227004 Fuel, lubricants and oils	55,010,933	
228002 Maintenance -vehicles	58,852,133	
231006 Furniture and fixtures	5,397,900	
231002 Machinery and equipment	28,679,912	
321103 Expenditure accounts	85,297,805	
263108 Transfers to Treasury: non-tax revenue	43,642,260	
263208 Gross tax	35,670,000	
511201 Revenue reserves	134,365,740	
415001 Trade payables	-	134,365,272
Total	<u>1,714,810,272</u>	<u>1,714,810,272</u>

Other relevant information:

1. Gross tax: The gross tax figure of Shs 35,670,000 represents releases to the ministry during the period under consideration, out of which Shs 25,000,000 was utilized to pay for taxes on machinery imported. The balance was unutilized by close of the year. No adjustments have been made in the books of the entity.
2. Expenditure account: A release of Shs 85,297,805 for salaries for the month of June 12 was made to pay staff by close of the month. However, Bank of Uganda remitted salaries after 5 July.
3. Unauthorized expenditure: A sum of Shs 35,000,000 was drawn from the capital development items to finance the recurrent budget. It was used to pay for stationery and allowances for the staff during the month of May. No authorization was sought from the Secretary to Treasury.
4. Payment of domestic arrears: During the year, the ministry paid domestic arrears amounting to Shs 32,455,000. This was funded from the motor vehicle maintenance budget.
5. Uncleared payment: One payment made to the supplier at the close of the year had not been cleared by Bank of Uganda. The amount involved was Shs 15,000,000.
6. Outstanding balance on letter of credit: A letter of credit for Shs 28,679,912 was opened in May to facilitate the purchase of a generator unit. By close of the year, Shs 24,698,500 had been drawn against the facility and the balance still remaining with Bank of Uganda LC account in favour of the vote.
7. Disposal of assets: The entity disposed of vehicles and other assorted assets worth Shs 42,532,000 through court bailiffs during the year. However, the bailiffs have not remitted the whole sum to the vote.

Required:

- (a) Prepare a statement of financial performance and position for the ministry as at 30 June 2012.

10 marks

- (b) Briefly discuss the treatment of the following items in public sector financial reporting:
 - (i) Provisions.
 - (ii) Letter of credit.
 - (iii) Depreciation.

- (iv) Grants.
- (v) Unspent cash balances.

(5 marks)

- (c) Nakaseke Hospital is a government owned health facility in Luwero district. It provides health care services free of charge and the following information relates to the period ended 30 June 2012.

Releases from central government for:	Shs
operations	98,500,100
drugs	65,425,710

Expenditure:	Shs
Salaries for staff	47,235,204
Night duty allowances	1,750,400
Training	2,578,500
Overseas travel	13,986,000
Immunisation costs	6,500,000
Drugs	71,255,000
Fuel and oils	24,000,000
Vehicle maintenance	3,600,000

The following information is also relevant:

	Shs
Opening balances on operation fund	32,000,000
Balance on operation fund at the beginning	(1,032,000)

Required

Prepare consolidated financial statements and fund balances for the period ended 30 June 2012

(5 marks)**(Total 20 marks)****Question 6**

- (a) Consolidated financial statements are becoming more common in the public sector.

Required:

Elaborate **five** reasons why consolidated financial statements are produced in the public sector.

(5 marks)

- (b) Bubbo Town Council (BTC) owns 45% of a transport company PWD Ltd, which specializes in transporting clients with special needs. BTC provides essential technical information to PWD Ltd in its transport business. As at

30 June 2012, PWD Ltd's statement of financial position showed total assets of Shs 400 million, and are owed Shs 30 million by BTC.

BTC set up a trading company, Musomeno Ltd, to provide carpentry services. Musomeno Ltd is 100% owned by BTC. During the year ending 30 June 2012, BTC consumed Shs 500 million worth of services supplied by Musomeno Ltd and Shs 120 million remained unpaid. The cost of the services provided by Musomeno Ltd to BTC was Shs 360 million. The net assets of Musomeno Ltd on the reporting date of 30 June 2012 were valued at Shs 1,120 million.

Required:

- (i) Explain, with relevant computations, the value of net assets belonging to PWD Ltd which should be included in BTC's consolidated statement of financial position as at 30 June 2012 in order to comply with IPSAS 7: Investments in Associates.
(4 marks)
- (ii) Explain how BTC will report its interest in Musomeno Ltd, in order to comply with IPSAS 6: Consolidated and Separate Financial Statements.
(4 marks)
- (iii) Describe the treatment of Musomeno Ltd on the consolidated statement of financial position as at 30 June 2012 if BTC only owned 80% of voting shares of Musomeno Ltd.
(3 marks)
- (c) According to IPSAS 7, whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee.

Required:

Explain **four** ways that may indicate that significant influence by an investor exists in another entity, in accordance with IPSAS 7.

(4 marks)

(Total 20 marks)

Question 7

- (a) Government of Uganda has put in place a regulatory and institutional framework for financial reporting in the public sector.

Required:

Examine the roles and responsibilities of the following:

- (i) The Accountant General (6 marks)
 - (ii) The Auditor General (6 marks)
- (b) Examine the principal reporting environmental differences between a government sector and a typical private business enterprise.

(8 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