

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA(U) EXAMINATIONS

### LEVEL TWO

#### ADVANCED FINANCIAL ACCOUNTING – PAPER 8

**MONDAY, 18 JUNE 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 **four** questions and only **three** are to be attempted. Each question carries 20 marks.
4. Section **C** has **two** questions and only **one** is to be attempted. Each question carries 10 marks.
5. Write your answer to each question in a separate answer booklet.
6. Please, read further instructions on the answer booklet, before attempting any question.

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## SECTION A

*This section has one compulsory question to be attempted.*

### Question 1

The following trial balance was extracted from the books of Muzinda Uganda Ltd, a small-sized company, at 31 May 2012:

	Shs'000'	Shs'000'
Revenue (note 1)		416,700
Cost of sales	177,000	
Operating expenses	60,000	
Loan interest paid (Loan 1)	4,500	
Distribution expenses	57,300	
Investment income		6,000
Land and building (note 3)	337,500	
Plant and equipment at cost	271,500	
Investments at amortised cost	63,000	
Accumulated depreciation on buildings, plant and equipment 1 June 2011		181,500
Equity shares of 20 cents per share fully paid		225,000
Revaluation reserves		120,000
Retained earnings 1 June 2011		27,900
18% Loan note (Loan 1)		25,000
18% Loan note (note 5- Loan 2)		50,000
Deferred tax balance 1 June 2011 (note 7)		18,000
Trade receivables	80,250	
Inventories 1 June 2011	49,950	
Bank		2,850
Trade payables		28,050
	<u>1,101,000</u>	<u>1,101,000</u>

Notes:

#### 1 Revenue

On 5 May 2012, Muzinda Uganda Ltd sold goods for a total sales price of Shs 18.2 million. These goods are to be used by the customer on a long-term basis. The contract of sale obliges Muzinda Uganda Ltd to provide two years servicing to the customer for no additional payment. The normal selling price of the goods without any agreement to provide servicing would have been Shs 16.2 million. A service contract of the type being provided by Muzinda Uganda Ltd to this customer would normally produce

service revenue of Shs 2 million per annum. Muzinda Uganda Ltd has included revenue of Shs 18.2 million in the trial balance.

## 2 Inventories

On 31 May 2012 the value of the inventories at cost at Muzinda Uganda Ltd's premises was Shs 48.5 million.

## 3 Non-current assets

On 1 June 2011, Muzinda Uganda Ltd revalued its land and building. The details are:

	Cost 1 June 2006	Valuation 1 June 2011
	Shs '000'	Shs '000'
Land	52,000	65,000
Buildings	208,000	272,500

The building had an estimated life of 40 years when it was acquired and this has not changed as a result of the revaluation. Depreciation is on a straight-line basis. The surplus on the revaluation has been added to the revaluation reserve, but no other movement on the revaluation reserve has been made. Plant and equipment is depreciated at 20% per annum on the reducing balance basis.

## 4 Grants

Muzinda Uganda Ltd constructed a new factory and because the company had created employment opportunities it received a grant from the Government of Uganda of Shs 159 million in respect of the factory costing Shs 597 million. It is depreciated at 20% per annum. The company's policy is to treat the grant as a deferred credit transferring a portion to revenue each year. The two transactions have not yet been incorporated in the company's books of account.

## 5 Borrowing costs

Muzinda Uganda Ltd further constructed a store at a cost of Shs 65 million over 5 months from 1 January 2012 to 31 May 2012. To assist the financing of the project Muzinda Uganda Ltd raised an additional 18% Shs 50 million loan (Loan 2) on 1 January and was immediately recorded in the books. The loan is to be repaid on 30 September 2012. The store was not to open until the following year. This store has not yet been included in the property under note 3 and the related cash movement has also not been recorded.

## 6 Trade receivables

On 27 January 2012 Muzinda Uganda Ltd sold trade receivables with an invoice value of Shs 45 million to a factor. The factor paid Shs 40 million to Muzinda Uganda Ltd on 27 April 2012 and took over the duties of collecting the debts. The balance of Shs 5 million (less an administrative fee of 1% of the amount advanced to Muzinda Uganda Ltd for every month the debts remain outstanding) will be paid to Muzinda Uganda Ltd when the invoices are settled. None of the outstanding debts were settled by 31 May 2012. If the factor is unable to collect the receivables within three months the legal title on the uncollected receivables returns to Muzinda Uganda Ltd. When Muzinda Uganda Ltd received the cash from the factor they debited cash and credited trade receivables with Shs 40 million.

## 7 Taxation

The directors have estimated the provision for income tax for the year to 31 May 2012 at Shs 52 million. The deferred tax provision at 31 May 2012 is to be adjusted to reflect the tax base of the company's net assets being Shs 74 million less than their carrying values. The rate of income tax is 30%. The movement on deferred tax should be charged to the income statement.

**Required:**

Prepare for Muzinda Uganda Ltd for the year ended 31 May 2012, a statement of:

(a) comprehensive income.

**(9 marks)**

(b) changes in equity.

**(4 marks)**

(c) financial position.

**(17 marks)**

**(Total 30 marks)**

**Note:** *Disclosure notes are not required. Clearly show all your workings.*

**SECTION B**

*Attempt three of the four questions in this section.*

**Question 2**

Irene owns some shares in Elitab Uganda Ltd, whose most recent financial statements are shown below. You have agreed to prepare an analysis of the financial performance and liquidity of the company for her.

Statement of Financial Position as at 31 May

	2012		2011	
Assets:	Shs million	Shs million	Shs million	Shs million
Non-current assets:				
Property, plant & equipment	6,650		3,710	
Intangibles	<u>2,800</u>		<u>-</u>	
		9,450		3,710
Current assets:				
Inventory	1,680		910	
Receivables	1,155		595	
Bank	<u>-</u>		<u>2,100</u>	
		<u>2,835</u>		<u>3,605</u>
Total assets		<u>12,285</u>		<u>7,315</u>
Equity and liabilities:				
Equity:				
Share capital and reserves				
Ordinary share capital		2,800		2,800
Share premium		1,050		1,050
Revaluation reserve		350		350
Retained earnings		<u>826</u>		<u>700</u>
Total equity		5,026		4,900
Liabilities:				
Non-current liabilities:				
Loans		4,550		1,050
Current liabilities				
Payables	1,309		1,015	
Taxation	560		350	
Overdraft	<u>840</u>		<u>-</u>	
		<u>2,709</u>		<u>1,365</u>
Total equity and liabilities		<u>12,285</u>		<u>7,315</u>

Statement of Comprehensive Income for the year ended 31 May

	2012		2011	
	Shs million	Shs million	Shs million	Shs million
Sales revenue		13,202		8,050
Cost of sales		<u>(6,580)</u>		<u>(4,760)</u>
Gross profit		6,622		3,290
Administration costs	2,443		1,561	
Distribution costs	1,295		805	
Interest payable	<u>476</u>		<u>91</u>	
		<u>(4,214)</u>		<u>(2,457)</u>
Profit before tax		2,408		833
Taxation		<u>(665)</u>		<u>(385)</u>
Profit for period		<u>1,743</u>		<u>448</u>

**Required:**

- Calculate **three** financial performance ratios and **three** liquidity ratios for 2012 and 2011 for Elitab (U) Ltd.  
(9 marks)
- Using the ratios you have calculated in part (a) above, comment on the performance and liquidity of Elitab (U) Ltd.  
(8 marks)
- Briefly explain any additional information about Elitab (U) Ltd that would help you to interpret the ratios.  
(3 marks)

**(Total 20 marks)**

### Question 3

- (a) Mr. Lukawago has been appointed as an accounting officer of Kitwe Town Council but does not understand the term 'accounting officer' in public sector accounting, and what the roles and responsibilities of an accounting officer are. He has learnt that you are knowledgeable in public sector accounting and therefore has approached you for assistance and advice.

**Required:**

Prepare a report to Mr. Lukawago explaining to him the term 'accounting officer' and the roles and responsibilities of an accounting officer.

**(10 marks)**

- (b) In a related development, Mr. Kiwewa, Lukwago's colleague has been transferred to the revenue section of the Finance Department of Kitwe Town Council to be responsible for accounting for revenue of the council, including all the local revenue received by the town council.

**Required:**

Explain to Mr. Kiwewa the steps he would need to take to ensure that all the local revenue of the town council is appropriately and effectively accounted for. The explanation should cover from receipt of the revenue up to the preparation of the relevant reports.

**(10 marks)**

**(Total 20 marks)**

### Question 4

- (a) Revenue is one largest figure / value that appears in the financial statements which should be recognised and measured appropriately. IAS 18: Revenue provides standard accounting practice in this area.

**Required:**

- (i) Explain the meaning of revenue and the basis of measurement under the principles of the standard.

**(2 marks)**

- (ii) Explain the criteria that need to be satisfied before revenue can be recognised under the principles of IAS 18.

**(6 marks)**

- (b) On 28 March 2012, Tabi (U) Ltd transferred goods to a third party, Eliza (U) Ltd, on a consignment basis. Eliza (U) Ltd undertook to sell the goods and remit the proceeds, less a commission of 10%, when the final purchaser has paid for them. The invoiced value of these goods (the price payable by the final purchaser) was Shs 25 million. The goods cost Tabi

(U) Ltd Shs 20 million to manufacture. By 31 March 2012 Eliza (U) Ltd had sold part of the goods at an invoiced price of Shs 15 million and received payment of Shs 10m. No payment had been made to Tabi (U) Ltd by Eliza (U) Ltd by 31 March 2012. After 31 March 2012 Eliza (U) Ltd sold the remaining goods, received all the proceeds, and remitted Shs 22.5 million (90% of Shs 25 million) to Tabi (U) Ltd .

**Required:**

Compute, in accordance with IAS 18, how much revenue should be recognised and any other amounts relating to this transaction that will be included in the statement of comprehensive income for the year ended 31 March 2012 and the statement of financial position at 31 March 2012, of Tabi (U) Ltd.

**(6 marks)**

- (c) Tabi (U) Ltd recently acquired a fish processing company at Masese from Danvick Ltd, for Shs 3 billion. Tabi (U) Ltd allocated the purchase consideration as follows:

	Shs million
Goodwill	360
Fishing quotas	600
Fishing boats (2 of equal value)	1,500
Other fishing equipment	150
Fish processing plant	300
Net current assets	<u>90</u>
	<u>3,000</u>

Shortly after the acquisition, one of the fishing boats sank and this reduced the fishing capacity. Due to this reduction in capacity, the value in use of the fishing business as a going concern is estimated at only Shs1.8 billion. The fishing quotas now represent a greater volume than one boat can fish and it is impossible to replace the lost boat. However, the fishing quotas are much in demand and could be sold for Shs 900 million. Tabi (U) Ltd has been offered Shs 375 million for the fish processing plant. The net current assets consist of accounts receivable and payable.

**Required:**

Calculate the amounts that would appear in the financial statements of Tabi (U) Ltd in respect of Danvick Ltd's assets after accounting for the impairment loss.

**(6 marks)**

**(Total 20 marks)**



**Question 5**

- (a) The executive director (ED) of the company you work for as senior accountant sponsored you for an ICPAU seminar that took place on 23 February 2012. Among the standards covered at the seminar was IAS 11: Construction Contracts. The company is contemplating joining the construction business but the ED is uncertain about what to include in contract revenue and costs. He has heard that the accounting standard normally requires that construction contracts should be accounted for using the percentage of completion basis and under certain circumstances they should be accounted for using the completed contract basis.

**Required:**

Write a report to the ED explaining what is included in contract revenue and costs, and the principles that underlie each of the two bases of accounting and describe the circumstances in which their use is appropriate.

**(9 marks)**

- (b) Due to the excessive number of buildings, the company decided in one of its board meetings to lease some of the buildings (estimated remaining life 20 years) to other companies on 30 June 2011 for five years. The company is responsible for any repairs and insurance of the buildings. The net present value of the income stream of Shs 130 million of the buildings (including the deposit) is being recognised in the income statement. The company estimates that the fair value of the buildings leased was Shs 182 million at the inception of the leases. Deposits of Shs 26 million were to be received by the company on 30 June 2012.

The company acquired construction equipment under lease arrangement on the following terms:

- Commencement of the lease was 1 October 2011.
- Term of lease 5 years.
- Annual payments in advance Shs 1.2 million.
- Cash price and fair value of the asset Shs 5.2 million at 1 October 2011.
- Implicit interest rate within the lease (as supplied by the lessor) 8% per annum (to be apportioned on a time basis where relevant).
- The company's depreciation policy for this type of plant is 20% per annum on cost (apportioned on a time basis where relevant).

**Required:**

Prepare extracts that would appear in the statement of comprehensive income and statement of financial position for the company for the year to 30 June 2012 for the above leases.

**(11 marks)**  
**(Total 20 marks)**

**SECTION C**

*Attempt one of the two questions in this section.*

**Question 6**

The International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements was approved by the International Accounting Standards Committee (IASC) Board in April 1989 for publication in July 1989, and adopted by the IASB in April 2001. The framework was superseded by the Conceptual Framework for Financial Reporting in September 2010. However, the remaining text of the original framework, among other things, contains the definition and recognition criteria for assets and liabilities.

**Required:**

- (a) Define the terms 'assets' and 'liabilities' and explain the important aspects of those definitions.
- (b) Explain why these definitions are of particular importance to the preparation of an entity's statement of financial position and statement of comprehensive income.

**(5marks)**  
**(5 marks)**  
**(Total 10 marks)**

**Question 7**

Public sector accounting is mainly about accountability, whereas private sector accounting is mainly about profit reporting.

**Required:**

Differentiate between public sector accounting and private sector reporting.

**(10 marks)**