

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

FINANCIAL REPORTING - PAPER 13

FRIDAY, 22 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 **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 10.
6. Write your answer to each question in a separate 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 has one compulsory question to be attempted.

Question 1

- (a) Kaasa Ltd was incorporated in Uganda. The company deals in value addition of agricultural produce for export. It is seeking technical advice from a qualified accountant in preparation of its financial statements for the year ended 31 December 2011 in order to comply with International Financial Reporting Standards. The company had the following assets and liabilities in its accounts before carrying out the necessary adjustments to prepare its financial statements:

Item as at 31	December 2011 Shs million	January 2011 Shs million
Buildings		140
Goodwill		60
Inventory (exclusive of inventory from Kayasi Ltd)	14	
Trade receivables	9	
Trade payables	13	
Cash at bank	40	

The company had made a provision for bad debts of Shs 3 million.

Kayasi Ltd, a fully owned subsidiary of Kaasa Ltd, sold goods costing Shs 30 million to its parent on 30 December 2011 for Shs 33 million and all these goods were still held in the inventory at 31 December 2011.

Kaasa Ltd depreciates its buildings at 5% per annum.

Tax allowance rate is 20% and the company pays corporation tax at 30%.

Required:

Calculate the deferred tax provision required as at 31 December 2011.

(6 marks)

- (b) Kayasi Ltd has a cash generating unit which had the following details of net assets as at 31 December 2011:

	Shs million
Goodwill	60
Land and buildings	120
Plant and equipment	180

At 31 December 2011, the net realizable value of the net assets was Shs 250 million and value in use was Shs 270 million.

Required:

Determine the value of each component of the cash generating unit as at 31 December 2011, and the total value for inclusion in their financial statements.

(6 marks)

- (c) Kaasa Ltd owns a plantation which comprises of 1,000 young Mivule trees that were 10 years at 31 December 2010. Mivule trees take 30 years to mature and will ultimately be processed into timber for use in making high quality furniture for export.

Only mature Mivule trees have established fair values by reference to a quoted price in an active market. The fair value of a mature tree was Shs 300,000 on 31 December 2010 and Shs 400,000 at 31 December 2011. The relevant cost of capital is 14%.

Required:

Determine the value of the 1,000 Mivule trees for the years ended 31 December 2010 and 2011 respectively.

(4 marks)

- On 1 January 2010, Kaasa Ltd granted 500 share options to each of its 20 employees. The options were conditional on the employees remaining with Kaasa Ltd for three years from that date. The exercise price of options was Shs 350, if the earnings of Kaasa Ltd, as at 1 January 2010, grew by an average of less than 10% per annum over the three years; or Shs 300, if the earnings grew by an average of 10% or more over the three years.

At 1 January 2011, it was estimated that the Shs 350 options had a value of Shs 150 each and that the Shs 300 options had a value of Shs 180.

During the year ended 31 December 2010, none of the employees left Kaasa Ltd, and none were expected to leave in the following two years.

During the year ended 31 December 2011, two of the employees left Kaasa Ltd, but no more were expected to leave before 1 January 2012

During the year ended 31 December 2010, earnings grew by 12%, but in view of general economic conditions, it was expected that growth over the next two years would be about only 7% per annum. However, in the year ended 31 December 2011, earnings grew by 11% and it was expected that earnings would grow by about 10% in the year ending 31 December 2012.

Required:

Prepare a memo to the directors explaining the:

- (i) accounting treatment of the share options; and
 - (ii) amounts included in the financial statements for years ended 31 December 2010 and 2011, showing all calculations. **(8 marks)**
- (d) (i) Explain the term 'deemed disposal' and the circumstances that give rise to a deemed disposal. **(3 marks)**
- (ii) Environmental reports cover issues like waste management, pollution, extent of physical degradation of the environment, the effect of an enterprise's activity upon wildlife as well as amounts invested in preserving the environment.

Required:

Discuss why it is important for a profit oriented enterprise to publish an environmental report.

(3 marks)
(Total 30 marks)

SECTION B: FINANCIAL REPORTING IN THE PRIVATE SECTOR

Attempt two of the three questions in this section.

Question 2

- (a) The rule of 'substance over form' attempts to deal with the substance over form problem.

Required:

Explain the reasons why companies may wish to deliberately exclude assets and liabilities from their statement of financial position.

(3 marks)

- (b) On 1 January 2008, Charlie Uganda Ltd (CUL), manufactures of corrugated carton boxes, entered into a lease agreement with Henry Ltd in respect of a corrugated carton box making machine. The cash price of the machine was Shs 7,710,000 and CUL agreed to pay a deposit of Shs 2 million and four further payments of Shs 2 million each subsequent 31 December. Under the terms of the lease CUL would be responsible for maintaining the machine and have the option to buy the machine for Shs 1,000 at the end of the lease. The lease contained no break clause. The asset had an expected life of four years at which time it would have no residual value.

The interest rate implicit in the lease was 15% and the company's financial year ends on 31 December.

Required:

In line with the principle of substance over form, explain the reporting treatment of the above transaction with the relevant extracts from the financial statements for the years ended 31 December 2008, 2009, 2010 and 2011.

(12 marks)
(Total 15 marks)

Question 3

Dijoliba Ltd has met the definition of small and medium-sized enterprise (SME) in its jurisdiction and wishes to comply with the International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs). The company already prepares its financial statements under the full IFRS but now wishes to seek advice on how it will deal with the following accounting issues in its financial statements for the year ended 30 November 2011.

Required:

Discuss how the following transactions should be dealt with in the financial statements of Dijoliba Ltd, with reference to the IFRS for Small and Medium-sized Entities.

- (a) On 1 December 2010, Dijoliba Ltd acquired 30% of the ordinary share capital of Ugara Ltd for Shs 300 million. For the year to 30 November 2011, Ugara Ltd recognised a profit of Shs 400 million and on 30 November 2011 Ugara Ltd declared and paid a dividend of Shs 150 million for the year ended 30 November 2011. At 30 November 2011, the fair value of Dijoliba Ltd's investment in Ugara Ltd stood at Shs 425 million. However, there is no published price quotation for Ugara Ltd. Dijoliba Ltd uses the equity model to value its investments in associates.

(5 marks)

- (b) On 1 December 2010, Dijoliba Ltd acquired 90% of the ordinary share capital of Baroons Ltd for Shs 570 million and the net assets were Shs 600 million. The fair value of the non-controlling interests was estimated at Shs 70 million. Dijoliba Ltd uses the full goodwill method to account for business combinations and the goodwill life cannot be estimated with any accuracy.

(5 marks)

- (c) During the year ended 30 November 2011, Dijoliba Ltd incurred the following expenditure to develop its own product:

	Shs million
Research as to the extent of the market	300
Product design	150
Prototype	250
Employee costs in refinement of final products	200
Development work undertaken to finalize design of product	500
Market research	200
Staff training costs	<u>100</u>
	<u>1700</u>

(2 marks)

- (d) Defined benefit obligation:

	30 November	
	2010	2011
	Shs million	Shs million
Present value of defined benefit obligation	300	400
Fair value of plan assets	240	330
Unrecognized actuarial losses	38	42
Average working lives of employees	12 years	

Dijoliba Ltd currently uses the 'corridor approach' to recognize actuarial gains and losses.

(3 marks)

(Total 15 marks)

Question 4

The following are summarized statements of financial position of Eagle Ltd, Cock Ltd and Hen Ltd as at 31 May 2011.

	Eagle Ltd Shs million	Cock Ltd Shs million	Hen Ltd Shs million
Assets			
Non-current assets:			
Tangible non-current assets	3,000	1,000	600
Investment in Cock Ltd	1,500		
Investment in Cock Ltd and Hen Ltd	<u>380</u>	<u>200</u>	<u>---</u>
	4,880	1,200	600
Current assets	<u>1,530</u>	<u>560</u>	<u>410</u>
Total assets	<u>6,410</u>	<u>1,760</u>	<u>1,010</u>
Equity and liabilities:			
Share capital	3,600	800	400
Share premium	600	200	100
Retained earnings	<u>1,600</u>	<u>400</u>	<u>210</u>
	5,800	1,400	710
Liabilities	<u>610</u>	<u>360</u>	<u>300</u>
Total Equity and Liabilities	<u>6,410</u>	<u>1,760</u>	<u>1,010</u>

Additional information:

- (i) Eagle Ltd acquired 80% of the ordinary share capital of Cock Ltd on 1 June 2008 for Shs 1,500 million when the retained earnings of Cock Ltd were Shs 200 million. The fair value of net assets of Cock Ltd was the same as its carrying amount at the date of acquisition. At the date of acquisition, the fair value of the non-controlling interests in Cock Ltd was Shs 300 million.
- (ii) Eagle Ltd and Cock Ltd acquired 40% and 25% for Shs 380 million and 200 million respectively of the ordinary share capital of Hen Ltd on 1 June 2009 when the retained earnings of Hen Ltd were Shs 100 million and those of Cock Ltd were Shs 300 million. On 1 June 2009, the fair value of the non-controlling interests in Hen Ltd was Shs 250 million.
- (iii) Eagle Ltd uses the full goodwill method to measure non-controlling interests.
- (iv) During the year ended 31 May 2011, Hen Ltd sold goods to Eagle Ltd worth Shs 125 million making a profit of 25% on cost. 20% of these goods were still in inventory on 31 May 2011.
- (v) During the year ended 31 May 2011, Eagle Ltd borrowed Shs 30 million from Cock Ltd and this amount was still outstanding at 31 May 2011.

- (vi) A review of assets on 30 May 2011 revealed that 50% of the goodwill on the acquisition of Cock Ltd was impaired.

Required:

Prepare a consolidated statement of financial position for Eagle Group as at 31 May 2011 in accordance with International Financial Reporting Standards.

(15 marks)

SECTION C: FINANCIAL REPORTING IN THE PUBLIC SECTOR

Attempt two of the three questions in this section.

Question 5

- (a) Describe the budgetary control systems used in the public sector of Uganda.

(7 marks)

- (b) Explain the challenges encountered in the use of budgetary control systems in the public sector of Uganda.

(5 marks)

- (c) Discuss the key problems encountered in measuring performance in the public sector.

(8 marks)

(Total 20 marks)

Question 6

The following information appeared in the trial balance of Urban Municipal Council for the year ending 30 June 2011

	Dr	Cr
	Shs '000'	Shs '000'
Interest paid	450,000	
Long-term loan		1,600,000
15% Mortgage Bond		800,000

On 1 July 2010, the municipal council started negotiations to purchase a piece of industrial land costing Shs 1 billion on which to erect a warehouse. The deal was finalized on 1 August 2010 at which stage the council was granted a bond of Shs 800 million equal to 80% of the purchase price of the collateral. The interest rate on the bond was 15% throughout the year. The architects had finalized plans by 1 September 2010 and construction began immediately. On 31 March 2011 the warehouse was complete and ready for use. The warehouse was not put into use until 1 June 2011, the date their lease on the originally rented warehouse expired.

Detailed construction records indicate that council employees spent 120,000 hours on the construction of the warehouse. The average charge out rate per employee was Shs 3,500 per hour. Raw materials costing Shs 800 million were used in the construction. Costs were incurred evenly throughout the construction period and it is presumed that the project was financed by the bond proceeds with the required top up drawn from other general borrowings.

The council's policy on borrowing costs is to capitalize the same where appropriate and has approached you as a consultant to provide guidance on the matter.

Required:

Prepare a report to the management of the council with relevant computations and explanatory notes indicating which borrowing costs are to be capitalized or expensed appropriately for the year ended 30 June 2011 in order to comply with the requirements of IPSAS 5: Borrowing Costs.

(20 marks)

Question 7

- (a) Governments and government entities usually have transactions in foreign currencies such as borrowing an amount of foreign currency or purchasing goods and services where the purchase price is designated as a foreign currency amount. They may also have foreign operations and transfer cash to and receive cash from those foreign operations.

Required:

Explain the requirements of the Cash Basis IPSAS: Financial Reporting under the Cash Basis of Accounting, regarding the treatment of foreign currency cash receipts, payments and balances, and unrealized gains and losses arising from changes in foreign currency exchange.

(6 marks)

- (b) According to IPSAS 6: Consolidated and Separate Financial Statements, consolidated financial statements shall include all controlled entities of the controlling entity, except for defined exclusions.

Required:

Examine the conditions set out in IPSAS 6 for the relationships between two entities that determine the existence of control for financial reporting purposes.

(14 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