

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL TWO

ADVANCED FINANCIAL ACCOUNTING – PAPER 8

MONDAY, 26 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 **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 on a fresh page in your answer booklet.
6. Please, read further instructions on the answer booklet, before attempting any question.

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SECTION A

The following trial balance was extracted from the books of Loro Ltd as at 31 October 2012:

	Note	Dr Shs'000'	Cr Shs'000'
Revenue			1,196,000
Production costs		521,000	
Distribution costs		64,400	
Advertising	6	73,600	
Administration expenses	1	239,200	
Inventories 31 October 2011		167,440	
Interest paid and payable on interest bearing borrowings		27,600	
Income tax	3		1,840
Dividends paid on equity shares		18,400	
Property, plant and equipment at cost	4	524,400	
Accumulated depreciation on property, plant and equipment at 31 October 2011	4		143,428
Suspense account	4		11,040
Research costs	4	54,900	
Trade receivables		559,300	
Cash and cash equivalents		380,868	
Trade payables			124,200
Provisions	1		23,000
Long-term interest bearing borrowings			368,000
Deferred tax	3		55,200
Issued equity capital	5		460,000
Accumulated profits			<u>248,400</u>
		<u>2,631,108</u>	<u>2,631,108</u>

Notes:

- Administration expenses include a provision of Shs 23 million for the costs of a legal claim lodged against Loro Ltd by one of its suppliers before 31 October 2012. The supplier is claiming Shs 92 million but the directors of Loro Ltd consider that there is a 25% chance of the claim being successful and have provided for 25% of the total claim.

2. The carrying value of inventories at 31 October 2012 was Shs 202.4 million. This figure was computed in accordance with the principles of IAS 2: Inventories.
3. Taxation:
 - (i) The estimated corporation tax on the profits for the year to 31 October 2012 is Shs 13.8 million.
 - (ii) During the year, Shs 17.48 million was paid as full and final settlement for corporation tax on the profits for the year ended 31 October 2011. The statement of financial position as at 31 October 2011 had included Shs 19.32 million in respect of this liability.
 - (iii) At 31 October 2012, the carrying values of the net assets of Loro Ltd exceeded their tax base by Shs 257.6 million.
 - (iv) Loro Ltd pays corporation tax at a rate of 30%.
4. Property, plant and equipment:
 - (i) Cost and accumulated depreciation

	Property		Plant and equipment
	Land	Buildings	
	Shs'000	Shs'000	Shs'000
Cost at 31 October 2012	110,400	165,600	248,400
Estimate of useful economic life (at date of purchase)	Infinite	30 years	5 years
Accumulated depreciation at 31 October 2011	0	41,400	102,028
 - (ii) For all tangible non-current assets depreciation is charged in full in the year of purchase, with no depreciation being charged in the year of sale. None of the non-current assets were fully depreciated at 31 October 2012. Depreciation is charged under administration costs.
 - (iii) During the year plant and equipment costing Shs 55.2 million and having been depreciated by a cumulative amount of Shs 41.4 million at 31 October 2012 was disposed of and the proceeds credited to a suspense account.
 - (iv) Loro Ltd's development plant project was completed on 31 July 2012 and is included in plant and equipment. Research costs of Shs 54.9 million were incurred by the end of the project. Management decided to capitalize the research cost as an intangible asset since it was incurred prior to bringing the project into use.
5. On 2 November 2012, Loro Ltd issued a further 10 million ordinary shares for Shs 140 million. The share issue has not been reflected in the above trial balance.

6. In September 2012, Loro Ltd paid Shs 73.6 million for a radio and television advertising campaign for its products that will run for 6 months from 1 September 2012 to 28 February 2013. The directors believe that increased sales as a result of the publicity will continue for two years from the start of the advertisements. Any advertising cost is charged under administration costs.

Required:

Prepare, for Loro Ltd for the year ended 31 October 2012, a statement of:

- | | |
|---------------------------|-------------------------|
| (a) comprehensive income. | (12 marks) |
| (b) changes in equity. | (3 marks) |
| (c) financial position. | (15 marks) |
| | (Total 30 marks) |

Hint: Clearly show all your workings.

SECTION B**Question 2**

The following financial statements relate to Padibe (U) Ltd for the year ended 30 September 2012.

Statement of Comprehensive Income:

	Shs'000'	Shs'000'
Turnover		1,674,000
Cost of sales:		
Opening inventory	489,600	
Purchases	1,118,160	
Closing inventory	<u>(511,200)</u>	
Cost of sales		<u>(1,096,560)</u>
Gross profit		577,440
Operating expenses:		
Salary expense	264,600	
Employee statutory expense	29,340	
Advertising expense	12,780	
Depreciation expense	68,400	
Sundry supplies expense	8,280	
Insurance expense	<u>3,780</u>	
Total operating expenses		<u>(387,180)</u>
Income from operations		190,260
Interest expense		<u>(36,000)</u>
Income before income taxes		154,260
Income tax		<u>(33,120)</u>
Net income		<u>121,140</u>

Statement of Financial Position as at 30 September:

	2012 Shs'000'	2011 Shs'000'
Assets:		
Non-current assets:		
Land	111,600	111,600
Building: cost	792,000	792,000
accumulated depreciation	(388,800)	(345,600)
Equipment: cost	152,080	133,200
accumulated depreciation	<u>(94,480)</u>	<u>(49,840)</u>
	<u>572,400</u>	<u>641,360</u>
Current assets:		
Inventory	511,200	489,600
Accounts receivable (net)	256,680	144,720
Prepaid insurance	1,620	1,980
Cash	<u>89,460</u>	<u>66,060</u>
	<u>858,960</u>	<u>702,360</u>
Total assets	<u>1,431,360</u>	<u>1,343,720</u>
Equity and liabilities:		
Share capital	621,900	584,300
Retained earnings	<u>300,060</u>	<u>178,920</u>
	<u>921,960</u>	<u>763,220</u>
Non-current liabilities:		
Loan mortgage	<u>388,800</u>	<u>410,400</u>
Current liabilities:		
Accounts payable	105,660	154,080
Salaries payable	7,560	8,820
Income tax payable	3,420	2,520
Interest payable	<u>3,960</u>	<u>4,680</u>
	<u>120,600</u>	<u>170,100</u>
Total equity and liabilities	<u>1,431,360</u>	<u>1,343,720</u>

Other transactions recorded by Padibe (U) Ltd:

- (i) Paid a loan installment of Shs 38,880,000 on the loan mortgage.
- (ii) Received payments from issue of shares, Shs 37.6 million having a par value of Shs 20 million.

Required:

- (a) Prepare a statement of cash flows for Padibe (U) Ltd for the year ended 30 September 2012 in accordance with IAS 7: Statement of Cash Flows, using the direct method.

(16 marks)

- (b) Briefly explain why the direct method may be preferable to the indirect method in the preparation of a statement of cash flows.

(4 marks)

(Total 20 marks)

Question 3

- (a) Explain the role played by the following in public financial management (PFM) in the local governments:

- (i) National Parliament.
- (ii) Auditor General.
- (iii) Local Government Public Accounts Committee.

(7 marks)

- (b) The Government of Uganda introduced a Commitment Control System (CCS) in Uganda in the financial year 1999/2000 after realizing that the arrears had reached an unimaginable level. Commitment control system is an expenditure control mechanism whereby spending units initiate incurrence of obligations such as contracts or other arrangements for which there is sufficient cash balance available or likely to be available at the time of payment. The CSS therefore prohibits accounting officers from ordering for goods/services unless there are funds as provided in the budget to pay for them.

Required:

- (i) Explain the benefits of CCS to local governments.
- (ii) Explain the challenges that local governments face in the implementation of the CCS.

(8 marks)

(5 marks)

(Total 20 marks)

Question 4

- (a) IAS 8: Accounting Policies, Changes In Accounting Estimates and Errors, governs the issues of selecting accounting policies, changes in accounting policies, changes in accounting estimates and correction of prior period errors.

Required:

- (i) Define the terms 'accounting policies' and 'accounting estimate'.
(2 marks)

- (ii) Explain how a change in accounting policies and a change in accounting estimates differ.
(8 marks)

- (b) Olam Construction Ltd won a contract to build a new 8 storeyed building, Scovia Plaza on Lira-Dokolo Street. Details of progress as at 1 November 2011 of the contract to build at a fixed price of Shs 840 million were as follows:

	Shs'000'
Contract revenue recognised to date	462,000
Contract expenses recognised to date	<u>357,000</u>
Profit to date	<u>105,000</u>

In February 2012, Olam Construction Ltd negotiated a variation to the contract with an agreed value of Shs 168 million with the client to include fire escapes alongside the building. Olam Construction Ltd estimated the additional cost would be Shs 134.4 million.

The accounting records of Olam Construction Ltd at 31 October 2012 show that total progress billings received by 20 August 2012 were Shs 678.3 million and the total contract costs incurred to 31 October 2012 were Shs 588 million. This includes tiles and adhesive materials worth Shs 97.6 million to be used at finalization of the building in 2013.

The receipt of progress billings is after a 3% retention by the customer. Since the date of the billing, it is reliably estimated that a further Shs 42 million (at selling value) of work has been completed. At 31 October 2012, an estimated further Shs 168 million of additional costs will need to be incurred to complete the building. These figures include the costs related to the contract variation. The customer had set specified performance standards which had been exceeded and incentives amounted to Shs 6 million.

Olam Construction Ltd calculates a percentage of completion of its contracts as the proportion of the contract revenues earned to date compared to the contract price.

Required:

Prepare extracts from the financial statements of Olam Construction Ltd for the above contract for the year to 31 October 2012.

(10 marks)
(Total 20 marks)

Question 5

- (a) IAS 10: Events after the Reporting Period (Revised) replaced IAS 10: Events after the Balance Sheet Date following the changes in terminology made by IAS 1: Presentation of Financial Statements in 2007. The standard sets out when entities should adjust their financial statements for events after the reporting period and the disclosures that should be made about the date when the financial statements were authorized for issue.

Required:

- (i) Explain why events occurring after the reporting period may be of importance; and describe the circumstances where the financial statements should and should not be adjusted.

(6 marks)

- (ii) In November 2012, during a review of Ayero (U) Ltd's draft financial statements (for the year ended 31 October 2012 and due to be authorized for issue in January 2013) the following matters came to light:

- Ayero (U) Ltd had a substantial investment in Kigali, Rwanda. In November 2012, the investment was confiscated by the Kigali Investment Authority due to a breach of investment laws. The carrying value of the investment was Shs 358 million.
- At 31 October 2012, the Ayero (U) Ltd head office premises were included in the draft financial statements at a value of Shs 144 million. A subsequent building surveyor's report showed that the premises had fallen in value by Shs 24 million. This was due partly to the Lira Municipality's new urban regulations that commenced on 26 November 2012.

Note: you may assume the above figures are material.

Required:

Explain how Ayero (U) Ltd should treat each of the above items under IAS 10.

(4 marks)

- (b) The objective of diluted earnings per share is consistent with that of basic earnings per share - to provide a measure of the interest of each ordinary share in the performance of an entity - while giving effect to all dilutive potential ordinary shares outstanding during the period.

Required:

- (i) Explain the relevance of the diluted earnings per share measure.

(3 marks)

- (ii) Ayero (U) Ltd had 82,800 shares in issue at the start of the year and made no issue of shares during the year ended 31 October 2012, but on that date there were outstanding options to purchase 9,200 ordinary shares at Shs 1,700 per share. The average fair value of ordinary shares was Shs 1,800. Earnings for the year ended 31 October 2012 were Shs 2,208,000.

Required:

Calculate the fully diluted earnings per share for the year ended 31 October 2012 for Ayero (U) Ltd.

(7marks)

(Total 20 marks)

SECTION C

Question 6

Discuss how the IAS 41: Agriculture requirements regarding the recognition and measurement of biological assets and agricultural produce are consistent with the International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements.

(10 marks)

Question 7

The Government of Uganda has rolled out an integrated financial management system (IFMS) in ministries and some agencies and local governments.

Required:

Briefly discuss the benefits of the implementation of the IFMS in these ministries, agencies and local governments.

(10 marks)