AFRICA UNIVERSITY

(A United Methodist-Related Institution)

"Investing in Africa's Future"

FACULTY OF MANAGEMENT AND ADMINISTRATION

COURSE TITLE: MAC 401 Advanced Accounting (Parallel)

SEMESTER 1: Final Examination October 2014

LECTURER: Mr S.N. Chuchu

TIME: 3 HOURS

INSTRUCTIONS

Answer **all five (5)** questions.

Start **each** question on a new page in your answer booklet.

The marks allocated to **each** question are shown at the end of the question.

Show all your workings.

Credit will be given for logical, systematic and neat presentations.

Question 1

(a) Gemini Limited incurred costs amounting to $27 000 during the financial year ended 30 June 2014. The costs relate to the modification of its existing software system to make it complaint with its new operating system. The expenditure incurred will only enable the software system to continue to perform as it did originally.

The managing director of Gemini Limited has decided that, in view of the amount involved, the costs should be capitalized at 30 June 2014.

Required:
Discuss, with reference to the recognition criteria of the conceptual framework for financial reporting, whether or not you agree with the managing director's decision. Assume that the amount is material. **[10 marks]**

(b) The summarized financial statements of Cancer Limited are as follows:

Statement of financial position as at 30 June 2014

	2014	**2013**
	$	**$**
ASSETS		
Non-current assets	242 000	122 000
Property, plant and equipment	136 000	82 000
Intangible asset	60 000	40 000
Financial assets at cost	46 000	-------
Current assets	79 000	61 000
Inventories	40 000	22 000
Trade receivables	39 000	15 000
Bank	--------	24 000
Total assets	321 000	183 000
EQUITY AND LIABILITIES		
Equity	157 000	109 000
Ordinary shares of $1 each	70 000	50 000
Revaluation surplus	12 000	-------
Retained earnings	75 000	59 000
Non-current liabilities	84 000	20 000
10% debentures	80 000	20 000
Deferred tax	4 000	-------
Current liabilities	80 000	54 000
Trade payables	42 000	32 000
Current tax payable	16 000	22 000
Bank	22 000	-------
Total equity and liabilities	321 000	183 000

Statement of profit or loss and other comprehensive income for the year ended 30 June 2014

	2014	2013
	$	$
Revenue	540 000	364 000
Cost of sales	(378 000)	(218 400)
Gross profit	162 000	145 600
Distribution costs	(46 000)	(26 000)
Administrative expenses	(69 000)	(40 000)
Finance costs	(8 000)	(1 000)
Profit before tax	39 000	78 600
Income tax expense	(12 000)	(22 600)
Profit for the year	27 000	56 000
Other comprehensive income	12 000	-------
Property revaluation gain arising during the year	16 000	-------
Tax expense	(4 000)	-------
Total comprehensive income for the year	39 000	56 000

Additional information:

1. Depreciation/amortization charges for the year ended 30 June 2014 were:

	$
Property, plant and equipment	23 000
Intangible asset	5 000

2. There were no disposals of non-current assets during 2014. However, property was revalued.
3. Dividends paid during the year amounted to $11 000.

Required:

Prepare extracts of the statement of cash flows for the year ended 30 June 2014 showing the calculation of **cash generated from operations only,** in accordance with IAS 7, using:

(i) the indirect method **[4 marks]**

(ii) the direct method **[6 marks]**

Question 2

The accountant of Sigma Limited prepared the following draft statement of profit or loss and other comprehensive income and statement of changes in equity for the year ended 30 June 2014:

Statement of profit or loss and other comprehensive income for the year ended 30 June 2014

	2014	2013
	$	$

Profit from operations (fully taxable)	2 703 250	1 960 000
Interest paid	(212 025)	(28 575)
Profit before tax	2 491 225	1 931 425
Income tax expense	(622 806)	(482 856)
Profit for the year	1 868 419	1 448569
Other comprehensive income	---------	---------
Total comprehensive income for the year	1 868 419	1 448 569

Statement of changes in equity for the year ended 30 June 2014

	Share capital	**Retained earnings**	**Total**
	$	**$**	**$**
Balance on 30 June 2012	500 000	6 355 000	6 855 000
Total comprehensive income for the year		1 448 569	1 448 569
Dividends	---------	(100 000)	(100 000)
Balance at 30 June 2013	500 000	7 703 569	8 203 569
Total comprehensive income for the year		1 868 419	1 868 419
Dividends	--------	(150 000)	(150 000)
Balance at 30 June 2014	500 000	9 421 988	9 921 988

Additional information:

1. The company commenced with the construction of its new factory premises 2 January 2012. All construction activities are expected to be completed by 31 December 2014, on which date the factory premises will be brought into use.
2. After the draft financial statements for the year ended 30 June 2014 had been prepared, the financial director of the company discovered that the accountant incorrectly did not capitalize borrowing costs on the factory premises, as he mistakenly did not regard the factory premises as a qualifying asset.
3. Borrowing costs incurred and amounts that should have been capitalized are as follows:

	2014	**2013**	**2012**
	$	**$**	**$**
Total borrowing costs incurred	212 025	28 575	80 100
Borrowing costs that should have been capitalized	131 525	28 575	72 000

4. Assume a tax rate of 25%. Also assume that the Zimbabwe Revenue Authority indicated that the tax assessments for 2012 and 2013 will be reopened, as the borrowing cost on the factory premises was not reflected as pre-production interest and was, therefore, incorrectly granted as a deduction when it was incurred.
5. Assume that there was no movement in deferred tax liability between 30June 2013 and 30 June 2014.

Required:

Prepare the statement of profit or loss and other comprehensive income and statement of changes in equity for the year ended 30 June 2014, to comply with the requirements of IFRS. Notes are not required. **[20 marks]**

Question 3

(a) On 1 July 2013, InfoTech Limited obtained a licence to operate a cell phone network for a period of 25 years. The total cost of the licence was $1 250 000. The licence is amortized on the straight-line basis over a period of 25 years, as it is expected that economic benefits relating to the licence will flow to the entity over this period.

On 30 June 2014, it is estimated that the licence will generate net cash inflows amounting to $212 500 per annum. A before-tax discount rate of 20% is considered appropriate. The expected future cash flows are lower than the original estimate because a similar licence was awarded to a major competitor on 1 January 2014. The licence can be sold on 30 June 2014 for $1 000 000. Assume that all the cash flows occur on the last day of every year.

Assume that the Zimbabwe Revenue Authority does not allow a deduction of the cost of the licence. Also assume a tax rate of 25%. The correct profit before tax for the year ended 30 June 2014 after taking the above information into account amounted to $750000.

Ignore deferred tax. The present value of $1 per period = $[1 - 1/(1+i)^n] \div i$.

Required:

1. Calculate the amortization and determine impairment loss, if any **[4 marks]**
2. Calculate the income tax expense **[3 marks]**
3. Prepare the statement of profit or loss and other comprehensive income for the year ended 30 June 2014. **[2 marks]**
4. Disclose the note: Profit before tax. **[3 marks]**

(b) Capricorn Limited acquired plant at a cost of $250 000. The plant consists of two components, A and B. Component A cost $150 000 and has a useful life of 15 years, while Component B cost $100 000 and has a useful life of 12 years. A major inspection, covering both components, needs to be performed every three years. On acquisition of the plant, an inspection, similar to the one that will be performed after three years, was estimated to cost $10 000. The residual value of the plant is negligible and depreciation is calculated on the straight-line basis.

Required:

1. Calculate the annual depreciation on the plant for the first three years. **[4 marks]**
2. Assume that, at the end of the third year, the inspection was performed at a cost of $11 000. Calculate the annual depreciation on the plant for the next three years thereafter. **[4 marks]**

Question 4

Solar Limited acquired 75% of the ordinary shares of Panel Limited on 1 July 2011 when the retained earnings of Panel Limited amounted to $16 000. The abridged statements of profit or loss and other comprehensive income of the two companies for the year ended 30 June 2014 are as follows:

	Solar Limited	**Panel Limited**
	$	**$**
Revenue	900 000	220 000
Cost of sales	(464 000)	(124 000)
Gross profit	436 000	96 000
Other income	15 000	---------
Other expenses	(280 000)	(44 000)
Profit before tax	171 000	52 000
Income tax expense	(40 000)	(16 000)
Profit for the year	131 000	36 000
Other comprehensive income	----------	----------
Total comprehensive income for the year	131 000	36 000

Additional information:

1. At date of acquisition, all assets and liabilities were considered to be fairly valued, except for an item of plant which had a fair value of $32 000 above its carrying amount. The remaining useful life of the plant at date of acquisition was four years. Depreciation is calculated on the straight-line basis and is charged to cost of sales.

2. During the year, Solar Limited sold goods to Panel Limited for $50 000. The goods were invoiced at cost plus 25%. At 30 June 2014, 50% of these goods remained unsold in the inventories of Panel Limited.

3. Dividends paid by the two companies during the year were:

	$
Solar Limited	90 000
Panel Limited	20 000

4. The goodwill arising on business combination was impaired by $4 000 at 30 June 2014.

5. Other income is made up of investment income.

6. Each ordinary share carries one vote.

7. Both companies did not issue additional shares during the year.

8. Assume a tax rate of 25%.

Required:

Prepare the consolidated statement of profit or loss and other comprehensive income of the group for the year ended 30 June 2014 in accordance with the requirements of IFRS. Notes and comparatives are not required. **[20 marks]**

Question 5

Gemini Limited holds an interest in Libra Limited. The following represents the equity of Libra Limited at 1 July 2012 and 30 June 2013:

	1 July 2012	**30 June 2013**
	$	**$**
Share capital	100 000	100 000
Revaluation surplus	150 000	150 000
Retained earnings	200 000	200 000
	450 000	750 000

The statements of profit or loss and other comprehensive income for the two companies are as follows:

	Gemini Ltd	**Libra Ltd**
	$	**$**
Revenue	2 000 000	2 400 000
Cost of sales	(1 050 000)	(1 200 000)
Gross profit	950 000	1 200 000
Other income	30 000	---------
Other expenses	(330 000)	(366 667)
Profit before tax	650 000	833 333
Income tax expense	(300 000)	(233 333)
Profit for the year	350 000	600 000
Other comprehensive income	-------	----------
Total comprehensive income for the year	350 000	600 000

Additional information:

1. In 1 July 2012, Gemini Limited acquired a 30% interest in Libra Limited for $150000. From this date, Gemini Limited exercised significant influence over Libra Limited.

2. It is the policy of Gemini Limited to measure investments in associates at cost in its separate financial statements.
3. All assets and liabilities were fairly valued at 1 July 2012.
4. Libra Limited declared a dividend of $100 000 on 30 June 2014.
5. Gemini's other income is made up of dividends receivable from Libra Limited.

Required:

(a) Prepare the statement of profit or loss and other comprehensive income of the group for the year ended 30 June 2014. **[17 marks]**

(b) Calculate the "investment in associate" for the group **[3 marks]**