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 November 2013

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) One of the qualitative characteristics of information identified in the Conceptual Framework for Financial Reporting is understandability.
Required:
Explain the meaning and purpose of understandability in the context of financial reporting. **[5 marks]**

(b) Tech Limited decided to develop a web site that would enable customers to order products online. In pursuance of this objective, the following activities were undertaken:

- A feasibility study was undertaken at a cost of $7 500, which revealed that there was indeed a demand for such a web site.
- Thereafter, Tech Limited acquired the necessary hardware at cost of $75 000, obtained a domain name at a cost of $3 000 and developed the necessary software at a cost of $45 000.
- Once this was done, the appearance of the web pages was designed at a cost of $12 000, after which the content of the web pages was developed at a cost amounting to $90 000.
- Then, employees were trained to operate the web site at a cost of $7 500.

Required:
Determine the accounting treatment of the above costs as required by IAS 16 and IAS 38. **[7 marks]**

(c) Libra Limited owns cash-generating unit (CGU) M. The following information is available for CGU M:

(i) CGU M consists of the following:

	Carrying amount	**Fair value less costs of disposal**
	$	**$**
Asset D	30 000	20 000
Asset E	20 000	10 000
Asset F	8 000	4 000
Goodwill	2 000	--------
	60 000	

(ii) The recoverable amount of CGU M amounts to $40 000.

Required:
Calculate the impairment loss of CGU M, the impairment loss to be recognized per asset and the carrying amounts of the assets after impairment has been taken into account. **[8 marks]**

Question 2

The following financial statements relate to Scorpio Limited:
Statement of financial position as at 31 December 2012

	2012 $	2011 $
ASSETS		
Non-current assets		
Property, plant and equipment	67 950	45 000
Cost	76 000	50 500
Accumulated depreciation	(8 050)	(5 500)
Financial assets at fair value through other comprehensive income	60 000	50 000
Current assets	51 550	32 750
Inventories	25 500	16 250
Trade receivables	17 500	10 500
Short-term investments	7 050	5 000
Cash	1 500	1 000
Total assets	179 500	127 750
EQUITY AND LIABILITIES		
Equity	146 300	94 050
Ordinary share capital	12 500	11 250
Mark-to-market reserve	7 500	--------
Retained earnings	126 300	82 800
Non-current liabilities	17 500	6 300
Long-term debt (including finance lease)	15 000	6 300
Deferred tax	2 500	------
Current liabilities	15 700	27 400
Trade payables	8 500	5 000
Interest payable	1 250	500
Current tax payable	5 950	21 900
Total equity and liabilities	179 500	127 750

Statement of profit or loss and other comprehensive income for the year ended 31 December 2012

	$
Revenue	252 500
Cost of sales	(110 000)
Gross profit	142 500
Other income	3 000
Distribution and administrative costs	(8 250)
Finance costs	(2 500)
Profit before tax	134 750
Income tax expense	(91 250)
Profit for the year	43 500
Other comprehensive income	
Gain on financial assets at fair value through other comprehensive income	7 500

Gain arising during the year	10 000
Tax expense	(2 500)
Total comprehensive income for the year	51 000

Additional information:

1. Distribution and administrative costs include depreciation on property, plant and equipment amounting to $2 750.
2. During the year, the company purchased property, plant and equipment at a cost of $26 500, of which $1 500 was acquired through a finance lease.
3. The company paid $1 000 towards the settlement of the debt arising from the finance lease.
4. The short-term investments are highly liquid, readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.
5. Other income is made up of investment income received during the year.
6. Plant with an original cost of $1 000 and accumulated depreciation amounting to $200 was sold for $800.

Required:
Prepare a statement of cash flows for the year ended 31 December 2012. Use the direct method. Your answer must comply with the requirements of IAS 7. **[20 marks]**

Question 3

The following items were extracted from the trial balance of Virgo Limited as at 31 December 2012:

	Dr	**Cr**
	$	**$**
Sales		250 000
Cost of sales	90 000	
Other expenses (not specified)	60 000	
Loss on disposal of vehicle (tax deductible)	15 000	
Depreciation on machinery for 2012	12 500	
Profit from inventory damaged by flood (cost = $25 000; insurance claim = $30 000) (taxable)		5 000
Loss due to expropriation of inventories by government (tax deductible)	6 000	
Machinery at cost	75 000	
Accumulated depreciation on machinery at 31 December 2012		12 500
Deferred tax liability at 1 January 2012		Nil

Additional information:

1. The date of purchase of machinery is 1 January 2012. The useful life of machinery was originally estimated to be six (6) years from date of purchase. Owing to technological changes, the remaining useful life as at 31 December 2012 is estimated to be only four (4) years. The change in useful life has yet to be reflected in the trial balance.
2. There are no other taxable, non-taxable, tax deductible, or non-deductible items besides those presented in the extract of the trial balance. Assume a tax rate of 25%. For tax purposes, the company elected to claim special initial allowance (SIA) of 25% on machinery in 2012.
3. **Deferred tax**

	Carrying amount	**Tax base**	**Taxable temporary differences**	**Deferred tax liability**
	$	**$**	**$**	**$**
Balance at 1 January 2012				Nil
Cost machinery at 01/01/2012	75 000	75 000		
Depreciation/SIA	(15 000)	(18 750)		
31 December 2012	60 000	56 250	3 750	938

Required:

(a) Prepare the statement of profit or loss and other comprehensive income for the year ended 31 December2012. **[16 marks]**

(b) Disclose the note: Profit before tax. **[4 marks]**

Your answer must comply with the requirements of IFRS.

Question 4

Aquarius Limited used general borrowings to construct plant, a qualifying asset in terms of IAS 23, during 2011. The average general borrowings during 2011 amounted to $2.5 million and the interest paid during the year amounted to $450 000. The company has a 31 December year-end and capitalizes borrowing costs on an annual basis. The following expenditure was incurred on the plant (a qualifying asset) at the following specific dates:

	$
1 January 2011	100 000
1 March 2011	175 000
1 July 2011	250 000
1 November 2011	525 000
Total expenditure	1 050 000

Other expenditures during 2011

	$
General administrative costs	4 000
Costs of testing	20 000
Pre-production costs	8 000
	32 000

The above other expenditures were not financed by borrowings.

Additional information:

1. The administrative costs are of a general and indirect nature.
2. The costs of testing comprise costs incurred to produce samples while testing whether the plant was functioning properly. The samples were sold at net proceeds of $2 000.
3. The pre-production costs were necessary to bring the plant to the condition necessary to be able to operate in the manner intended by management.
4. The plant was ready for use on 31 December 2011 and immediately put to use.
5. The market-related before-tax interest was 20% during 2011.
6. Assume that a liability exists to dismantle and remove the plant at the end of its useful life at a cost of $16 000.
7. The plant is depreciated using the straight-line method over eight years, taking into account a residual value of $28 000.
8. The present value of $1 = $1/(1+i)^n$

Required:

1. Calculate the cost at which the plant was recognized on 31 December 2011 as required by IAS 23 and IAS 16. **[16 marks]**
2. Calculate the carrying amount of the plant on 31 December 2012.

[4 marks]

Question 5

Moon Limited acquired 75% of the ordinary shares of Lunar Limited for $90 000 two years ago when the equity of the investee consisted of ordinary share capital amounting to $100 000 ($1 shares) and retained earnings amounting to $5 124. The abridged statements of profit or loss and other comprehensive income of the two companies for the year ended 31 December 2012 are as follows:

	Moon Limited	**Lunar Limited**
	$	**$**
Revenue	64 600	38 000
Cost of sales	(51 200)	(26 000)
Gross profit	13 400	12 000

Distribution costs	(1 600)	(1 800)
Administrative expenses	(3 800)	(2 400)
Profit before tax	8 000	7 800
Income tax expense	(2 200)	(1 600)
Profit for the year	5 800	6 200
Other comprehensive income	-------	-------
Total comprehensive income for the year	5 800	6 200

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 $2 000 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, Moon Limited sold goods to Lunar Limited for $24 000. The goods were invoiced at cost plus 50%. At 31 December 2012, 20% of these goods remained unsold in the inventories of Lunar Limited.

3. The goodwill arising on business combination was impaired by $500 at 31 December 2012.

4. Each ordinary share carries one vote.

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

6. 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 31 December 2012 in accordance with the requirements of IFRS. Notes and comparatives are not required. **[20 marks]**