AFRICA UNIVERSITY

(A United Methodist-Related Institution)

"Investing in Africa's Future"

FACULTY OF MANAGEMENT AND ADMINISTRATION

COURSE TITLE: MAC 401 Advanced Accounting (Conventional)

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 comparability.

Required:

Explain the meaning and purpose of comparability in the context of financial reporting and, hence, outline the role of consistency within the characteristic in relation to changes in accounting policy. **[6 marks]**

(b) Capricorn Limited undertook a project to construct a qualifying asset in terms of IAS 23. The company capitalizes borrowing costs on an annual basis. The following data relates to the asset:

Date of commencement of construction	1 January 2011
Balance at 1 January 2012	
Expenditure to date (excluding borrowing costs)	$250 000
Borrowing costs capitalized	$90 000
Finance available from 1 January to 31 December 2012	
Debentures	$400 000 @ 16% p.a.
Bank overdraft	$300 000 @ 17% p.a.
General loan	$150 000 @ 20% p.a.

Costs incurred evenly during 2012

	$
1 January to 31 March	150 000
1 April to 30 June	170 000
1 July to 30 September	200 000
1 October to 31 December	120 000

Additional information:

1. None of the finance available from 1 January to 31 December 2012 is considered specific to this project.
2. Construction of the asset was completed on 31 December 2012.

Required:

(i) Calculate the borrowing costs capitalized in 2012. **[8 marks]**

(ii) Calculate the total cost of the asset at 31 December 2012. **[6 marks]**

Question 2

(a) Gemini Limited acquired machinery at a cost of $800 000 on 1 January 2011 that is used to produce goods to order for customers. The machinery had an estimated residual value of $50 000 and an estimated useful life of five years, neither of which has changed. The company uses the straight-line method of depreciation.

On 31 December 2012, Gemini Limited was informed by a major customer, who buys products produced by the machinery, that it would no longer be placing orders with Gemini Limited. Even before this information was received, Gemini Limited had been having difficulty finding work for this machinery. The company now estimates that net cash inflows earned from the machinery for the next three years will be as follows:

	$
Year ending 31 December 2013	220 000
Year ending 31 December 2014	180 000
Year ending 31 December 2015	170 000

Additional information:

1. It is still expected that the machinery will be sold for its estimated residual value on 31 December 2015.
2. The company has confirmed that there is no market in which to sell the machinery at 31 December 2012.
3. The before-tax discount rate is 10% and the present value of $1 = $1/(1+i)^n$

Required:
Determine whether the machinery is impaired. **[7 marks]**

(b) On 1 January 2012, Phonet Limited obtained a licence to operate a cell phone network for a period of 25 years. The total cost of the licence was $2 500 000. 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 31 December 2012, it is estimated that the licence will generate net cash inflows amounting to $425 000 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 July 2012. The licence can be sold on 31 December 2012 for $2 000 000. 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 31 December 2012 after taking the above information into account amounted to $1500 000.

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

Required:

1. Calculate the amortization and impairment loss **[5 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 31 December 2012. **[2 marks]**
4. Disclose the note: Profit before tax. **[3 marks]**

Question 3

(a) Libra Limited acquired plant at a cost of $500 000. The plant consists of two components, A and B. Component A cost $300 000 and has a useful life of 15 years, while Component B cost $200 000 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 $20 000. 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 $22 000. Calculate the annual depreciation on the plant for the next three years thereafter. **[4 marks]**

(b) Gamma Limited, a manufacturer of several products, was incorporated on 1 January 2009. All the company's property, plant and equipment were acquired on this date and were available for use immediately. The following information with regard to property, plant and equipment was extracted from the company's statement of financial position as at 31 December 2011:

	Cost	Accumulated depreciation	Carrying amount
	$	$	$
Land	225 000	----------	225 000
Factory building	600 000	(36 000)	564 000
Plant and machinery	437 500	(213 500)	224 000
Motor vehicles	152 500	(74 500)	78 000
	1 415 000	324 000	1 091 000

The company has always depreciated its plant and machinery and motor vehicles at 20% per annum on the reducing balance basis. However, at 31 December 2012, the directors of the company decided to depreciate these assets on the straight-line basis over their remaining useful lives, as from 1 January 2012.

On 1 January 2012, the remaining useful lives of the assets were as follows:

Plant and machinery	3 years
Motor vehicles	2 years

Depreciation on factory building is provided at 2% per annum on the straight-line basis.

Required:

1. Calculate the depreciation for 2011 and 2012 **[5 marks]**
2. Disclose the notes: (a) Accounting policy; (b) Profit before tax. **[7 marks]**

Question 4

The summarized financial statements of Alpha Limited are as follows:

Statement of financial position as at 31 December 2012

	2012 $	2011 $
ASSETS		
Non-current assets	121 000	61 000
Property, plant and equipment	68 000	41 000
Intangible asset	30 000	20 000
Financial assets at cost	23 000	--------
Current assets	39 500	30 500
Inventories	20 000	11 000
Trade receivables	19 500	7 500
Bank	-------	12 000
Total assets	160 500	91 500
EQUITY AND LIABILITIES		
Equity	78 500	54 500
Ordinary shares of $1 each	35 000	25 000
Revaluation surplus	6 000	------
Retained earnings	37 500	29 500
Non-current liabilities	42 000	10 000
10% debentures	40 000	10 000
Deferred tax	2 000	-------
Current liabilities	40 000	27 000
Trade payables	21 000	16 000
Current tax payable	8 000	11 000
Bank	11 000	------
Total equity and liabilities	160 500	91 500

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

	2012 $	2011 $
Revenue	270 000	182 000
Cost of sales	(189 000)	(109 200)
Gross profit	81 000	72 800
Distribution costs	(23 000)	(13 000)
Administrative expenses	(34 500)	(20 000)
Finance costs	(4 000)	(500)
Profit before tax	19 500	39 300
Income tax expense	(6 000)	(11 300)
Profit for the year	13 500	28 000
Other comprehensive income	6 000	-------
Property revaluation gain arising during the year	8 000	-------

Tax expense	(2 000)	-------
Total comprehensive income for the year	19 500	28 000

Additional information:

1. Depreciation/amortization charges for the year ended 31 December 2012 were:

	$
Property, plant and equipment	11 500
Intangible asset	2 500

2. There were no sales of non-current assets during 2012. However, property was revalued.
3. Dividends paid during the year amounted to $5 500.

Required:
Prepare the statement of cash flows for the year ended 31 December 2012. Use the indirect method in accordance with IAS 7. Notes and comparatives are not required.
[20 marks]

Question 5

Scorpio Limited acquired 75% of the ordinary shares of Taurus Limited on 1 January 2010 when the retained earnings of Taurus Limited amounted to $4 000. 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:

	Scorpio Limited	**Taurus Limited**
	$	**$**
Revenue	225 000	55 000
Cost of sales	(116 000)	(31 000)
Gross profit	109 000	24 000
Investment income	3 750	-------
Other expenses	(70 000)	(11 000)
Profit before tax	42 750	13 000
Income tax expense	(10 000)	(4 000)
Profit for the year	32 750	9 000
Other comprehensive income	-------	-------
Total comprehensive income for the year	32 750	9 000

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 $8 000 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, Scorpio Limited sold goods to Taurus Limited for $12 500. The goods were invoiced at cost plus 25%. At 31 December 2012, 50% of these goods remained unsold in the inventories of Taurus Limited.

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

	$
Scorpio Limited	22 500
Taurus Limited	5 000

4. The goodwill arising on business combination was impaired by $1 000 at 31 December 2012.

5. Each ordinary share carries one vote.

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

7. 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]**