COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

NMAC 203: INTERMEDIATE ACCOUNTING

END OF SECOND SEMESTER EXAMINATION

MAY 2023

LECTURER: DR P KORERA

DURATION: 3 HOURS

INSTRUCTIONS

You are required to answer questions as instructed

Answer **ALL** questions

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

Credit will be awarded for logical, systematic and neat presentations

QUESTION 1 (20 Marks)

After preparing a draft statement of profit or loss for the year ended 30 September 2022 and adding the year's profit (before any adjustments required by notes (i) to (v) below) to retained earnings, the summarised trial balance of Clarion as at 31 March 2023 is:

	$000	$000
Equity shares of $1 each		35,000
Retained earnings – 31 March 2023		33,100
8% loan notes (note (i))		20,000
Plant and equipment at cost (note (ii))	77,000	
Right- of- use plant (note (iii))	8,000	
Accumulated depreciation plant and equipment – 1 April 2022		19,000
Investments through profit or loss – value at 1 April 2022 (note (iv))	6,000	
Inventory at 31 March 2023	11,700	
Trade receivables	20,500	
Bank		1,900
Deferred tax (note (v))		2,700
Trade payables		9,400
Environmental provision (note (ii))		4,000
Lease liability (note (iii))		4,200
Loan note interest paid (note (i))	800	
Suspense account (note (i))	5,800	
Investment income (note (iv))		500
	129,800	129,800

The following notes are also relevant.

(i) On 31 March 2023, one quarter of the 8% loan notes were redeemed at par and six months' outstanding loan interest was paid. The suspense account represents the debit entry corresponding to the cash payment for the capital redemption and the outstanding interest.

(ii) *Property, plant and equipment*

Included in property, plant and equipment is an item of plant with a cost of $14 million purchased on 1 April 2022 However, the plant will cause environmental damage which will have to be rectified when it is dismantled at the end of its five-year life The present value (discounting at 8%) on 1 April 2022 of the rectification is $4 million. The environmental provision has been correctly accounted for, however, no finance cost has yet been charged on the provision. No depreciation has yet been charged on plant and equipment which should be charged to cost of sales on a straight-line basis over a five-year life No plant is more than four years old.

(iii) The right-of-use plant was acquired on 1 April 2022 under a five-year lease with an initial deposit of $2.3 million and annual payments of $1.5 million on 31 March each year The present value of the annual payments under the lease (**excluding the initial deposit**) at 1 April 2022 was $5.7 million, the lease has an implicit rate of interest of 10%, and the right-of-use plant has been correctly capitalised The lease liability in the trial balance above represents the initial liability less the first annual payment.

(iv) The investments through profit or loss are those held at 31 March 2023 (after the sale below). They are carried at their fair value as at 1 April 2022, however, they had a fair value of $6.5 million on 31 March 2023. During the year an investment which had a carrying amount of $1.4 million was sold for $1.6 million. Investment income in the trial balance above includes the profit on the sale of the investment and dividends received during the year.

(v) A provision for current tax for the year ended 31 March 2025 of $3.5 million is required. At 31 March 2023, the tax base of Clarion's net assets was $12 million less than their carrying amounts. The income tax rate of Clarion is 25%.

Required:
(a) Prepare Clarion's statement of financial position as at 31 March 2023. **(15 marks)**
(b) Prepare extracts from the statement of cash flows for Clarion for the year ended 31 March 2023 in respect of cash flows from investing and financing activities. **(5 marks)**
Notes to the financial statements are not required.

QUESTION 2 (20 Marks)

During the current year Astley obtained a new grant towards the purchase of an item of plant. The directors are aware that the grant should be accounted for in accordance with IAS 20 *Government Grants and Disclosure of Government Assistance* but are unsure of its application

Below is an extract of Astley's trial balance for the year ended 31 December 2022:

	$	$
Plant cost at 1 January 2022	390,000	
Plant accumulated depreciation at 1 January 2022		220,000
Government grants at 1 January 2022		100,000

Details of plant and government grants during the year are as follows:

(i) Included in the above trial balance figures is an item of plant that was disposed of on 1 January 2022 for $30,000 and had originally cost $48,000 on 1 January 2019. The plant was being depreciated on a straight line basis over four years assuming a residual value of $8,000.

(ii) An item of plant was acquired on 1 July with the following costs:

$

Base cost	95,000
Transport and installation	12,000
Pre-production testing	3,000

The plant qualified for a government grant of 20% of the base cost of the plant, the grant was received on 28 December 2022 but has not yet been accounted for. The plant is to be depreciated on a straight line basis over its useful economic life of five years.

(iii) All other plant is being depreciated at 15% on a reducing balance basis.

(iv) Depreciation is calculated on a time apportioned basis.

(v) $15,000 of the $100,000 government grant at 1 January 2022 should be reclassified as a current liability at 31 December 2022 and $15,000 of the deferred income needs to be released to the statement of profit or loss (amortised).

(vi) It is company policy that capital grants are recognised on a deferred income basis.

Required:

Prepare extracts of Astley's statement of profit or loss and statement of financial position in respect of plant and government grants for the year ended 31 December 2022. **(20 marks)**

QUESTION 3 (20 Marks)

In February 2022, an inter-city train operated by Zack did what appeared to be superficial damage to a storage facility of a local company. The directors of the company expressed an intention to sue Zack but, in the absence of legal proceedings, Zack had not recognised a provision in its financial statements to 31 March 2022. In July 2022, Zack received notification for damages of $1.2 million, which was based upon the estimated cost to repair the building. The local company claimed the building was much more than a storage facility as it was a valuable piece of architecture which had been damaged to a greater extent than was originally thought. The head of legal services advised Zack that the company was clearly negligent but the view obtained from an expert was that the value of the building was $800,000. Zack had an insurance policy that would cover the first $200,000 of such claims.

After the financial statements for the year ended 31 March 2023 were authorised, the case came to court and the judge determined that the storage facility actually was a valuable piece of architecture. The court ruled that Zack was negligent and awarded $300,000 for the damage to the fabric of the facility.

Required:

(a) Advise the directors of Zack as to the correct accounting treatment of the above in the financial statements for the year ended 31 March 2023. **(8 marks)**

The directors have discovered that some accruals were double-counted within the trade payables balance as at 31 March 20X2. This meant that expenditure for services was overstated in the prior year financial statements by $2 million. Zack has since reviewed its accounting systems and processes and has made appropriate changes. It has introduced additional internal controls to ensure that such estimation problems are unlikely to recur.

The directors of Zack are aware that they should follow the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when selecting or changing accounting policies, changing estimation techniques, and correcting errors. They are also aware that the Board has issued an exposure draft (ED/2018/1 *Accounting Policy Changes)* to address growing criticism of IAS 8.

Required:

(b) Discuss the correct treatment of the Zack's accruals error in its financial statements for the year ended 31 March 20X3. **(4 marks)**

(c) Discuss the role of judgement when selecting an entity's accounting policies. **(8 marks)**

QUESTION 4 (20 Marks)

(a) MMGF, a public limited company, has entered into several share related transactions during the period and wishes to obtain advice on how to account for them.

(i) On 1 May 2022, MMGF granted 500 share appreciation rights (SARs) to its 300 managers. All of the rights vested on 30 April 2024 but they can be exercised from 1 May 2024 up to 30 April 2026. At the grant date, the value of each SAR was $10 and it was estimated that 5% of the managers would leave during the vesting period. The fair value of each SAR is as follows:

Date	**Fair value** ($)
30 April 2023	9
30 April 2024	11
30 April 2025	12

All of the managers who were expected to leave employment did leave the company as expected before 30 April 2024. On 30 April 2025, 60 managers exercised their options when the intrinsic value of the right was $10.50 and were paid in cash.

MMGF is confused as to whether to account for the SARs under IFRS 2 *Share-based Payment* or IFRS 13 *Fair Value Measurement*, and would like advice as to how the SARs should have been accounted for between the grant date and 30 April 2025. **(8 marks)**

(ii) MMGF issued shares during the financial year. Some of those shares were subscribed for by employees who were existing shareholders, and some were issued to an entity, GGRF, which owned 5% of MMGF's share capital. Before the shares were issued, MMGF offered to buy a building from GGRF and agreed that the purchase price would be settled by the issue of shares.

MMGF requires advice about how to account for these two transactions. **(7 marks)**

(b) Briefly explain the principles outlined in IFRS 1 *First Time Adoption of IFRS* that must be applied when an entity adopts full IFRS Standards for the first time. **(5 marks)**

Required:

Advise the directors of MMGF on their various requests above.

Note: The mark allocation is shown against each of the three issues.

QUESTION 5 (20 Marks)

Previous leasing standards (e.g. IAS 17) were heavily criticised by financial statement users. One reason for this was that lessees were often not required to recognise lease liabilities on the statement of financial position. IFRS 16 *Leases* was issued in response to such criticisms.

Required

(a) Discuss some of the key changes to financial statements which investors will see when companies apply the lessee accounting requirements in IFRS 16. **(8 marks)**

(b) For a company with significant off-balance sheet leases, discuss the likely impact that IFRS 16 will have generally on accounting ratios and particularly on:

(i) Earnings before interest and tax to interest expense (interest cover); **(3 marks)**

(ii) Earnings before interest and tax to capital employed (return on capital employed); **(3 marks)**

(iii) Debt to earnings before interest, tax, depreciation and amortisation (EBITDA). **(3 marks)**

Marks will be awarded in this question for clarity and quality of discussion. **(3 Marks)**

END OF EXAMINATION PAPER