"Investing in Africa's Future"

COLLEGE OF BUSINESS AND MANAGEMENT SCIENCES

NMAC401: ADVANCED FINANCIAL ACCOUNTING

END OF FIRST SEMESTER EXAMINATIONS

NOVEMBER 2024

LECTURER: P. KORERA

TIME: 3 HOURS

INSTRUCTIONS

ANSWER ***ALL*** QUESTIONS on the Africa University answer booklet provided

MARKS ALLOTED TO EACH QUESTION ARE SHOWN

CLEAR AND NEATLY PRESENTED WORK WILL BE AWARDED MARKS FOR PRESENTATION

QUESTION 1 (25 Marks)

On 1 June 2024, PRM Ltd acquired 80% of the equity share capital of SFD Ltd. The consideration consisted of two elements: a share exchange of three shares in PRM for every five acquired shares in SFD and $800,000 cash. The share issue has not yet been recorded by PRM. At the date of acquisition shares in PRM had a market value of $5 each. Below are the summarised draft financial statements of both entities.

Statements of financial position as at 30 September 2024

	PRM	SFD
	$000	**$000**
Non-current assets		
Property, plant and equipment	25,500	13,900
Investments	1,800	-
	27,300	13,900
Current assets		
Inventory	5,300	500
Receivables	4,200	1,100
Bank	3,000	800
	12,500	2,400
Total assets	**39,800**	**16,300**
Equity and liabilities		
Equity shares of $1 each	12,000	5,000
Other equity reserve – 30 September 2023 (note (iv))	500	-
Retained earnings	12,300	4,500
	24,800	9,500
Liabilities		
Current liabilities	15,000	6,800
Total equity and liabilities	**39,800**	**16,300**

The following information is relevant:

(i) At the date of acquisition, the fair values of SFD's assets were equal to their carrying amounts with the exception of its property. This had a fair value of $1.2 million **below** its carrying amount, and had a remaining useful life of 8 years at the date of acquisition. SFD has not incorporated this in its financial statements.

(ii) PRM had $2 million (at cost to PRM) of inventory that had been supplied in the post-acquisition period by SFD as at 30 September 2024 SFD made a mark-up on cost of 25% on these sales.

(iii) PRM had a trade payable balance owing to SFD of $350,000 as at 30 September 2024. This did not agree with the corresponding receivable in SFD's books due to a $130,000 payment made to SFD, which SFD has not yet recorded.

(iv) PRM's investments include investments in shares which at the date of acquisition were classified as fair value through other comprehensive income (FVTOCI) The investments have increased in value by $300,000 during the year. The other equity reserve relates to these investments and is based on their value as at 30 September 2023. There were no acquisitions or disposals of any of these investments during the year ended 30 September 2024.

(v) PRM's policy is to value the non-controlling interest at fair value at the date of acquisition, deemed to be $3.5 million.

(vi) Consolidated goodwill was impaired by $1.5 million at 30 September 2024.

(vii) SFD generated net profit of $3.9 million for the year ended 30 September 2024.

Required:

Prepare the consolidated statement of financial position for PRM as at 30 September 2024.
(25)

<u>QUESTION 2 (25 Marks)</u>

On 1 April 2024 PDA purchased 80% of the equity shares in SVA. On the same date PDA acquired 40% of the 40 million equity shares in ABA paying $2 per share.

The statement of profit or loss for the year ended 30 September 2024 are:

	PDA	*SVA*	*ABA*
	$000	$000	$000
Revenue	210,000	150,000	50,000
Cost of sales	(126,000)	(100,000)	(40,000)
Gross profit	**84,000**	**50,000**	**10,000**
Distribution costs	(11,200)	(7,000)	(5,000)
Administrative expenses	(18,300)	(9,000)	(11,000)
Investment income (interest and dividends)	9,500	-	-
Finance costs	(1,800)	(3,000)	-
Profit (loss) before tax	**62,200**	**31,000**	**-6,000**
Income tax (expense) relief	(15,000)	(10,000)	1,000
Profit (loss) for the year	**47,200**	**21,000**	**-5,000**

The following information is relevant:

(i) The fair values of the net assets of SVA at the date of acquisition were equal to their carrying amounts with the exception of an item of plant which had a carrying amount of $12 million and a fair value of $17 million. This plant had a remaining life of five years (straight-line depreciation) at the date of acquisition of SVA. All depreciation is charged to cost of sales.
(ii) The fair value of the plant has not been reflected in SVA's financial statements.
(iii) No fair value adjustments were required on the acquisition of the investment in ABA.
(iv) Immediately after its acquisition of SVA, PDA invested $50 million in an 8% loan note from SVA. All interest accruing to 30 September 2024 has been accounted for by both entities. SVA also has other loans in issue at 30 September 2024.
(v) SVA paid a dividend of $8 million during the year.
(vi) After the acquisition, PDA sold goods to SVA for $15 million on which PDA made a gross profit of 20%. SVA had one third of these goods still in its inventory at 30 September 2024. PDA also sold goods to ABA for $6 million, making the same margin. ABA had half of these goods still in inventory at 30 September 2024.
(vii) The non-controlling interest in SVA is to be valued at its (full) fair value at the date of acquisition.
(viii) The goodwill of SVA has been impaired by $2 million at 30 September 2024. Due to its losses, the value of PDA's investment in ABA has been impaired by $3 million at 30 September 2024.
(ix) All items in the above statement of profit or loss are deemed to accrue evenly over the year unless otherwise indicated.

Required:

(i) Calculate the carrying amount of the investment in ABA to be included within the consolidated statement of financial position as at 30 September 2024. **(7)**

(ii) Prepare the consolidated statement of profit or loss for the PDA Group for the year ended 30 September 2024. **(18)**

QUESTION 3 (25 Marks)

(a) WY is considering purchasing equity shares in a regional airport called MN. It would be one of three shareholders. The majority shareholder would hold 60.2% of voting shares, the second shareholder would hold 20% of voting shares and WY would hold 19.8% of the voting shares. The board of directors consists of ten members. The majority shareholder will be represented by six of the board members, while WY and the other shareholder will be represented by two members each. A shareholders' agreement will state that certain board and shareholder resolutions require either unanimous or majority decision. There is no indication that the majority shareholder and the other shareholders will act together in a common way. WY will provide MN with maintenance and technical services and will send a team of management experts to give business advice to the board of MN. WY does not propose to account for its investment in MN as an associate. WS believes that the majority owner of MN will use its influence as the parent to control and govern it.

Required:

Discuss if WY's proposed accounting treatment for its investment in MN is in accordance with International Financial Reporting Standards. **(7)**

(b) CRP operates in the power industry, and owns 45% of the voting shares in KRN. KRN has four other investors which own the remaining 55% of its voting shares and are all technology companies. The largest of these holdings is 18%. KRN is a property developer and purchases property for its renovation potential and subsequent disposal. CRP has no expertise in this area and is not involved in the renovation or disposal of the property. The board of directors of KRN makes all of the major decisions but CRP can nominate up to four of the eight board members. Each of the remaining four board members are nominated by each of the other investors. Any major decisions require all board members to vote and for there to be a clear majority. Thus, CRP has effectively the power of veto on any major decision. There is no shareholder agreement as to how KRN should be operated or who will make the operating decisions for KRN. The directors of CRP believe that CRP has joint control over KRN because it is the major shareholder and holds the power of veto over major decisions. The directors of CRP would like advice as to whether or not they should account for KRN under IFRS 11 Joint Arrangements. **(6)**

(c) On 1 January 2023, HRE obtained planning permission to build a new office building. Construction commenced on 1 March 2023. To help fund the cost of this building, a loan for $5 million was taken out from the bank on 1 April 2023. The interest rate on the loan was 10% per annum.

Construction of the building ceased during the month of July due to an unexpected shortage of labour and materials.

By 31 December 2023, the building was not complete. Costs incurred to date were $12 million (excluding interest on the loan).

Required:

Discuss the accounting treatment of the above in the financial statements of HRE for the year ended 31 December 2023. **(12)**

QUESTION 4 (25 Marks)

a) Sebb Co runs a unit that suffers a massive drop in income due to the failure of its technology on 1 January 2024. The following carrying amounts were recorded in the books immediately prior to the impairment:

	$million
Goodwill	20
Technology	5
Brands	10
Land	50
Buildings	30
Other net assets	40

The recoverable value of the unit is estimated at $85 million. The technology is worthless, following its complete failure. The other net assets include inventory and receivables. It is considered that the carrying amount of other net assets is a reasonable representation of their net realisable value.

Required:

Show the impact of the impairment on 1 January 2024**. (10)**

b) St. Valentine produced cards and sold roses. However, half way through the year ended 31 March 2024, the rose business was closed and the assets sold off, incurring losses on the disposal of non-current assets of $76,000 and redundancy costs of $37,000. The directors reorganised the continuing business at a cost of $98,000. Trading results may be summarised as follows:

	Cards	**Roses**
	$000	**$000**
Revenue	650	320
Cost of sales	320	150
Distribution	60	90
Administration	120	110

Other trading information (to be allocated to continuing operations) is as follows:

	$000
Finance costs	17
Tax	31

Required:

(a) Draft the statement of profit or loss for the year ended 31 March 2024. **(10)**

(b) Explain how an IFRS 5 *Discontinued Operations* presentation can make information more useful to the users of financial statements. **(5)**