

ZIMBABWE EZEKIEL GUTI UNIVERSITY



**DEPARTMENT OF ACCOUNTING AND FINANCE
B. COM ACCOUNTING**

COURSE: FINANCIAL REPORTING FOR COMPANIES

COURSE CODE: CAC203

27 JULY 2017

DURATION: 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. No cell phones are allowed in the examination venue.
2. Answer **ALL FOUR** questions
3. Begin each question on a new page.
4. The number of marks allocated to each question or part question is shown in brackets
5. All questions carry twenty five marks each.
6. Hand-held, self-powered, non-programmeable, silent calculators are allowed into the examination.
7. Your answers must comply with the requirements of International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS).

Question 1

- a) IAS 11, *Construction Contracts* deals with accounting requirements for construction contracts whose duration usually spans more than one accounting period. Discuss the requirements for the recognition of construction contracts' revenue and profit. (5 marks)
- b) On 30 April 2017 Chubb Ltd had the following unfinished long-term contracts which had commenced in the current period:

Contract	Mkumbura	Beitbridge	Chirundu	Total
	\$'000	\$'000	\$'000	\$'000
Contract price	1,000	700	1,300	3,000
Estimated total costs	800	600	1,100	2,500
Costs to date:				
Material purchased	200	200	300	700
Wages	110	90	150	350
Electricity	21.5	32	45.5	99
Hire of equipment				150
Design and technical assistance				200
General administration costs				150
Finance costs				100
Insurance				100
Sub-contractors	300	100	200	600
				2,449

Additional information

- i) Chubb Ltd uses the percentage of completion method to determine profit on construction contracts, which is determined by reference to the proportion that contract costs incurred to date bear to the estimated contract costs.
- ii) Included in the material purchased are the following amounts which were confirmed as inventories as at end of year:

Mkumbura	\$20,000
Beitbridge	\$50,000
Chirundu	\$50,000

iii) The hired equipment was used on the contracts as follows:

Mkumbura	35%
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Beitbridge	65%
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iv) Design and technical assistance as well as insurance costs must be allocated between the contracts based on estimated total costs.

v) Payments to sub-contractors include the following prepayments:

Mkumbura	\$200,000
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Chirundu	\$50,000
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You are **required** to calculate the contract profit for each contract as well as the profit before tax for Chubb Ltd for the year ended 30 April 2016. (20 marks)

[Total 25 Marks]

Question 2

a) Daniel Ltd. has performed well but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management now anticipate being able to use the machine for a further four years after 30 June 2016, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for Daniel Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. Evelyn thought that the projections were too conservative and she intended to use the highest figures each year. These were as follows:

	\$'000
Year ended 30 June 2017	230
Year ended 30 June 2018	160
Year ended 30 June 2019	100
Year ended 30 June 2020	95

The above cash inflows should be assumed to occur on the last day of each financial year. The discount rate is 9%. The machine could have been sold at 30 June 2016 for \$420,000, net of selling expenses. The machine had been revalued previously, and at 30 June 2013 an amount of \$30,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 30 June 2016 was \$550,000.

Required

Determine whether the equipment should be impaired and record the transactions in books of accounts for Daniel Ltd. for the year ended 30 June 2016. (15 marks)

- b) On 1 July 2015, Hero entered into a four-year lease agreement for a new, specialised piece of machinery. The machine, which had a cash value of \$627 200, was leased under an agreement which requires Hero to make four annual payments of \$153,600 on 30 June each year, and an initial non-refundable deposit of \$80,000. The deposit was paid on 1 July 2015, and the first annual payment was duly made on 30 June 2016. Both payments were posted to administrative expenses. The machine has an estimated useful life of four years, and Hero is responsible for the maintenance of the machine during the lease term. Hero allocates finance charges using the sum-of-the-digits method.

Required

Account for the lease transaction in the books of Hero and if necessary prepare journal entries to rectify the posting error for the payments. (10 marks)

[Total: 25 marks]

Question 3

IAS 38 *Intangible Assets* sets out the principles of accounting for the recognition and measurement of intangible assets. The standard differentiates between intangible assets acquired individually, those acquired as part of a business combination, and those which are internally generated. IAS 38 relies on the concept of fair value to measure intangible assets, but the strength of the fair value test varies depending on the objective.

Hands Ltd has entered into the following transactions during the financial year ended 31 March 2017. The company seeks to maximise the reported value of its assets wherever possible.

- i) On 1 April 2016, Hands Ltd acquired, from a bankrupt competitor, a licence to provide radio broadcast services to a region within Zimbabwe. This licence would have been originally issued by the government for a ten-year period at zero cost, but has a market value due to its exclusivity. The cost of the licence to Hands was \$3.3 million, and the remaining useful economic life was 6 years. (3 marks)
- ii) On 1 April 2016, Hands Ltd commenced work on development of a new technology to enhance the quality of radio broadcasts. It purchased several patents at a cost of \$2 million and spent a further \$6 million developing the technology, as well as \$2 million researching

the international market for the technology in advance of its launch. The directors of Hands Ltd were confident throughout the development process that the technology had massive potential to generate future economic benefit. On 31 March 2017, this opinion was validated when a rival broadcaster offered Hands Ltd \$15 million for its partially developed technology project. (4 marks)

iii) As a result of Hands Ltd's growing reputation in the broadcasting industry, the directors commissioned a consulting firm to value its brand name. The brand name has not been recognised as an asset in the financial statements to date. On 31 March 2017, the consultants issued a report stating that the fair value of Hands Ltd's brand was \$20 million. (3 marks)

iv) Hands Ltd has a portfolio of patents it developed over the past few years. These represent technologies and processes used in the company's business to generate economic benefits. The total carrying value of these patents was \$2.8 million at 1 April 2016. They originally had a 15-year useful economic life, but on average seven years remain to their expiry date. The directors propose, at 31 March 2017, to revalue this portfolio to its estimated fair value of \$5 million. (4 marks)

Required:

a) Discuss the requirements of IAS 38 *Intangible Assets* with respect to the initial recognition and measurement of intangible assets acquired:

i) separately for cash, (4 marks)

ii) as part of a business combination, (3 marks)

iii) internally generated. (4 marks)

b) In each of the scenarios (i) to (iv) above, prepare a briefing note for Hands Ltd's financial controller advising on the appropriate accounting treatment for the intangible assets for year ended 31 March 2017. (14 marks)

[Total: 25 Marks]

Question 4

- a) Apex is a publicly listed Hypermarket chain. During the current year, it started the construction of a new shop. The directors are aware that in accordance with IAS 23 *Borrowing Costs* certain borrowing costs may be capitalised.

Required:

Explain the circumstances when, and the amount at which, borrowing costs should be capitalised in accordance with IAS 23. **(6 marks)**

- b) Details relating to construction of Apex's new store:

Apex obtained a \$10 million unsecured loan with an effective interest rate of 7.5% on 1 April 2015. The loan was specifically issued to finance the building of the new shop which meets the definition of a qualifying asset in IAS 23. Construction of the shop commenced on 1 May 2015 and it was completed and ready for use on 28 February 2016, but did not open for trading until 1 April 2016. During the year trading at Apex's other shops was below expectations so Apex suspended the construction of the new store for a two-month period during July and August 2015. The proceeds of the loan were temporarily invested for the month of April 2015 and earned interest of \$40,000.

Required:

Calculate the borrowing cost that should be capitalised as part of the cost of the new shop for the year ended 31 March 2016. **(7 marks)**

- c) Define the following terms and phrases as provided by the relevant International Accounting Standards:

- | | |
|---------------------------|------------------|
| i) Contingent liability | (2 marks) |
| ii) Construction contract | (2 marks) |
| iii) Finance lease | (2 marks) |
| iv) Redemption of shares | (2 marks) |
| v) Corporate asset | (2 marks) |
| vi) Intangible asset | (2 marks) |

[Total: 25 Marks]

*****END OF EXAMINATION*****