

# ZIMBABWE EZEKIEL GUTI UNIVERSITY



## DEPARTMENT OF ACCOUNTING AND FINANCE

### B. COM ACCOUNTING

**COURSE: FINANCIAL REPORTING FOR COMPANIES**

**COURSE CODE: CAC203**

**DURATION: 3 HOURS**

22 January 2019

#### 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.

### Question 1

The following draft Statement of Financial Position was drawn up as at 31 July 2016 on the instructions of the directors of Tandamanzi Ltd. On subsequent examination of the books and records the finance director has prepared a list of issues, which she believes may require amendments to the draft statement presented.

#### Tandamanzi Ltd: Statement of Financial Position as at 31 July 2016

Millions (\$)

##### Non-current assets:

Land & buildings	420
Plant & equipment	600
Investment property	120
Equity investments	<u>360</u>
	<u>1,500</u>

##### Current assets:

Inventory	80
Trade receivables	125
Cash & bank	<u>30</u>
	<u>235</u>

##### Total assets:

1,735

##### Equity:

Equity share capital	400
Share premium	200
Retained earnings:	
Balance 1 August 2015	375
Profit for year	95
Dividend declared	<u>(30)</u>
	440
Other components of equity:	
Balance 1 August 2015	128
Other comprehensive income for year	<u>35</u>
	<u>163</u>

1,203

##### Non-current liabilities:

Finance lease obligations	175
5% debenture 2020	<u>150</u>
	325
<b>Current liabilities:</b>	
Trade payables	110
Finance lease obligations	35
Provision for warranty claim	12
Corporation tax due	20
Final dividend due	<u>30</u>
	<u>207</u>
<b>Total equity &amp; liabilities</b>	<b><u>1,735</u></b>

**The following notes are to be considered in so far as they are relevant:**

- (i) Land and buildings are carried after charging depreciation for the year. On 31 July 2016, a piece of property, carried at \$130 million, was revalued to \$110 million. This revaluation has not been accounted for. The revaluation reserve (included with other components of equity) had a balance of \$12 million due to previous revaluations of this property.
- (ii) Plant and equipment are carried after charging depreciation for the year. A sale agreement was entered into during July 2016 to sell some of this plant. The plant sold had a carrying value of \$45 million at the date of sale and was sold for an agreed price of \$39 million. No cash has yet been received in respect of this sale, as a 30- day credit period was agreed with the purchaser. No entry has been made to record this transaction.
- (iii) The above figure for investment properties does not take account of the results of a fair valuation exercise carried out on 31 July 2016. The result of this was that the investment properties had a fair value of \$125 million at that date. Tandamanzi Ltd adopts the fair value model for investment properties.
- (iv) The equity investments had a fair value of \$380 million at 31 July 2016, which has not yet been incorporated into the financial statements. Tandamanzi has made an election to take all fair value gains and losses on equity investments to “other comprehensive income” as permitted by IFRS 9 - *Financial Instruments*.
- (v) The 5% debenture was issued on 1 August 2015 for cash proceeds of \$150 million, and was correctly recorded. The redemption terms of this debenture are such that the effective rate of interest to maturity was 6.5%. The only other entry made in respect of the debenture was the payment of \$7.5 million interest on the due date 31 July 2016.
- (vi) Tandamanzi Ltd offers a 12-month warranty on all goods sold to retail customers. A provision is maintained for the expected cost of honouring this warranty. This has not been updated as at 31

July 2016. Tandamanzi sold 40,000 units of its relevant product during the year, all of which qualify for warranty. It expects 10% of these to need minor repairs at an average cost of \$500 each, and 3% to need major repair at a cost of \$10,000 each. All costs are expected to be incurred within 12 months.

(vii) Ignore the taxation effects of any adjustments you make.

**REQUIREMENT:**

- (a) Prepare a schedule showing any corrections required to the profit and other comprehensive income for the year. (12 marks)
- (b) Redraft the Statement of Financial Position at 31 July 2016 taking the above into account. (16 marks)
- (c) Assess the key differences between operating leases and finance leases. (12 marks)

**[Total: 40 MARKS]**

**Question 2**

IAS 33 - *Earnings per Share* sets out the requirements for calculating and disclosing the basic earnings per share figure for quoted entities.

The following figures appeared in the Consolidated Statement of Profit or Loss and Other Comprehensive Income of Magaba Ltd for year ended 31 July 2016, together with comparatives for 2015:

	<b>Millions (\$)</b>	<b>millions (\$)</b>
	<b>2016</b>	<b>2015</b>
Profit before taxation	400	300
Taxation on profit	<u>(75)</u>	<u>(60)</u>
Profit for the period	325	240
Other comprehensive income – revaluation gains on land	<u>30</u>	<u>10</u>
Total comprehensive income for the period	355	250
Profit for the year attributable to:		
Owners of the parent	280	210
Non-controlling interests	<u>45</u>	<u>30</u>
Profit for the year	<u>325</u>	<u>240</u>
Total comprehensive income for the year attributable to:		
Owners of the parent	310	220
Non-controlling interests	45	30
<b>Total comprehensive income for the year</b>	<b>355</b>	<b>250</b>

The following figures are taken from Magaba's Statement of Financial Position as 31 July 2016, together with comparatives:

	Millions (\$)	millions (\$)
	2016	2015
Equity share capital of \$0.50 each	460	200
4% Preference shares – non-redeemable, non-cumulative	100	100
Share premium	215	60
Retained earnings	688	570
Other equity reserves	90	60
Non-controlling interests	<u>85</u>	<u>40</u>
Total equity	1,638	1,030

During the year ended 31 July 2016 the following changes took place to the issued share capital of Magaba Ltd:

- i) 100 million equity shares were issued in conjunction with the acquisition of another business. These were issued at full market price at the date of issue, 1 November 2015.
- ii) 150 million ordinary shares were issued for cash to existing shareholders on 1 February 2016. The issue price was \$1.50 per share, which represented a discount of 25% on the traded price immediately before the issue of (\$2.00).
- iii) On 31 July 2016, a bonus issue of 270 million shares was completed, capitalising \$135 million of retained earnings. Also on this date the preference dividend due for the year, and an equity dividend of \$23 million, were paid.

#### REQUIREMENT:

- (a) Discuss the significance of the earnings per share (EPS) figure to the analysis of company performance. Why is it important to have an accounting standard in this area? (6 marks)
- (b) Applying the requirements of IAS 33 - *Earnings Per Share* to the information above, calculate the basic EPS for year ended 31 July 2016 and the comparative figure for 2015 to be reported in the 2016 financial statements. The EPS figure originally reported in 2015 was \$0.525. (14 marks)

**[Total: 20 MARKS]**

#### Question 3

Under the IASB's *Conceptual Framework for Financial Reporting* certain qualitative characteristics of useful financial information are identified. These are subdivided into characteristics considered fundamental and those considered to be enhancing. The two fundamental characteristics identified by the framework are 'relevance' and 'faithful representation'. In order for financial transactions to be represented faithfully in the financial statements, the principle of 'substance over form' should be

applied. This means that wherever there is a difference between the legal form of a transaction and its economic substance, the financial statements should reflect the economic substance.

The following transactions were entered into by Chinengundu Ltd (Chinengundu) during the year ended 31 July 2016:

- i) On 1 August 2015, Chinengundu agreed to sell a plot of land to another entity for \$5 million cash. The land had a carrying value and a fair value at that date of \$4 million. On the same date Chinengundu entered into a binding agreement with the same counterparty to repurchase the land on 1 August 2016 for \$5.5 million cash.
- ii) On 1 July 2016, Chinengundu delivered goods with an invoice value of \$400,000 to a customer. The agreement with the customer was that the goods would be paid for only if the customer sold them on. If they were not sold by 31 August 2016, the customer could pay for them, or return them without penalty. Chinengundu could request the return of the goods at any time until the customer paid for them. The goods had cost Chinengundu \$340,000 to manufacture. On 31 July 2016, none of the goods had been paid for by the customer, and none returned.
- iii) On 10 July 2016, Chinengundu delivered goods with an invoice value of \$250,000 to another customer. The agreement with this customer was that the goods would be paid for on sale to a third party or on 31 August 2016. However, in this case there was no right of return once the customer accepted delivery and was satisfied the goods were as ordered and of good quality. The goods had cost Chinengundu \$160,000 to manufacture. On 31 July 2016, none of the goods had been paid for by the customer.

**REQUIREMENT:**

- (a) Why it is considered important that the economic substance of a transaction be reflected in the financial statements over its legal form? (4 marks)
- (b) Describe in general terms the features of a transaction that suggest that its economic substance may differ from its legal form. (4 marks)
- (c) In the case of (i) to (iii) above, explain using journals, how the transactions should be accounted for under IFRS, justifying for your answers. Assume no entries have already been made in respect of the above transactions. (12 marks)

**[Total: 20 MARKS]**

#### Question 4

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is an important standard regulating the recognition of liabilities and the use of provisions. It has been especially useful in controlling the abuse of provisions to manage reported earnings.

#### REQUIREMENT:

- (a) Define a provision and discuss in detail the three conditions that must be satisfied for a provision to be recognised under IAS 37. Your answer should explain how the requirements of IAS 37 are consistent with the principles contained in the conceptual framework. (10 marks)
- (b) Discuss briefly how Chidhindo Ltd should record each of the following transactions and events in compliance with the requirements of IAS 37.
- (i) A decision was taken by the board of Chidhindo Ltd shortly before the year-end to close down a division. The costs of the closure are estimated to total \$30 million. The decision was announced in principle, but detailed implementation plans have not been made yet. (2 marks)
- (ii) Chidhindo Ltd has traditionally repainted its premises every five years. The next painting is due in a year's time. The entity proposes to accrue as a provision the expected cost of repainting the premises. (2 marks)
- (iii) Chidhindo Ltd has sold 5,000 units of a product to customers during the past 12 months with a year's warranty attaching. Experience has shown that 3% of goods sold require warranty repair at an average cost of \$200 per unit. (4 marks)
- (iv) Chidhindo Ltd has guaranteed the debts of its associate company up to a maximum amount of \$3 million. The associate is in excellent financial health and the directors are of the opinion that it is unlikely the guarantee will ever be called in. (2 marks)

[Total: 20 MARKS]

\*\*\*END OF PAPER\*\*\*