



ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTING

DEPARTMENT OF ACCOUNTING AND FINANCE

EXAMINATION PAPER

COURSE CODE : CAC 203
COURSE TITLE : FINANCIAL REPORTING FOR COMPANIES
SPECIAL REQUIREMENT : Non-programmable calculator
DURATION : 3 Hours
LEVEL : 2.1
DATE : 21 NOV 2019

INSTRUCTIONS TO CANDIDATES:

1. No cell phones are allowed in the examination venue.
2. Answer all questions.
3. Begin each question on a new page.
4. The number of marks for each question or part question is shown in brackets []

SECTION A: MULTIPLE CHOICE

NB: For each question in this section, write the letter that corresponds with the correct answer. Each question carries 2 marks.

QUESTION 1

- i. Which of the following statements about the application of IFRS in accordance with The Conceptual Framework is the most correct?**
- A. Entities that are not expected to continue in the foreseeable future are to prepare their accounts on the net realisable value assumption.
 - B. Entities may change the valuation and measurement of assets provided they disclose the change and its effects in the financial report.
 - C. Entities within the scope of the Corporations Act can choose to apply Australian or International accounting standards when preparing their financial reports.
 - D. Entities may prepare financial statements on a cash flow basis provided that they meet the characteristics of comparability, understandability, timeliness and verifiability.
- ii. Which of the following are essential characteristics of a lease?**
- A. Certainty of term, exclusive possession, and rent
 - B. Certainty of term, exclusive possession, and creation by deed.
 - C. Certainty of term and exclusive possession.
 - D. Exclusive possession only.
- iii. Which one of the following is NOT a way in which a lease could be terminated?**
- A. Abatement
 - B. Surrender
 - C. Expiry
 - D. Merger
- iv. In a lease arrangement, the owner of the asset is:**
- A. The lesser.
 - B. The lessee.
 - C. The lessor.
 - D. The leaser.

v. Which of the following is not a financial lease?

- A. A leveraged lease.
- B. An operating lease.
- C. A sale-and-leaseback.
- D. Both A and B.
- E. None of the above.

vi) According to the IASB Framework, the main purpose of financial reporting is to:

- A. Help managers to run the business
- B. Calculate prudently distribute profit
- C. Enable investors to make economic decisions
- D. None of the above

vii. Which of the following statements best describes the term 'going concern'?

- A. The potential to contribute to the flow of cash and cash equivalents to the entity.
- B. The ability of the company to continue in operation for the foreseeable future.
- C. The income less expense of an entity are negative.
- D. When current assets less current liabilities become negative.

viii. Which one of the following is listed in the IASB Framework as 'underlying assumptions' regarding financial statements?

- A. The financial statements are reliable
- B. Any changes of accounting policy are neutral
- C. The financial statements are prepared under the accruals basis
- D. None of the above is correct.

ix. On 1 October 20X4, Karen Co. commenced drilling for oil from an undersea oilfield. Karen Co. is required to dismantle the drilling equipment at the end of its five-year licence. This has an estimated cost of \$30m on 30 September 20X9. Karen Co.'s cost of capital is 8% per annum and \$1 in five years' time has a present value of 68 cents.

What is the provision which Karen Co. would report in its statement of financial position as at 30 September 20X5 in respect of its oil operations?

- A. \$32,400,000
- B. \$22,032,000
- C. \$20,400,000
- D. \$1,632,000

x. In accordance to IAS 23 what is a qualifying asset?

- A. Is an asset that takes a substantial period of time to get ready for its intended use
- B. Is an asset that was once used for long period of time?
- C. These are assets held for own use and are in the company's name.
- D. Intangibles and inventories that takes a substantial amount of time to get ready for their intended use.

xi. Which of the following is not an external source of indicators of impairment with regards to IAS 36?

- A. Market value declines.
- B. Negative changes in technology, markets, economy or laws.
- C. Increase in markets interest rates.
- D. Worse economic performance than expected.

xii. Which of the following should be capitalised in the initial carrying amount of an item of plant?

- (1) Cost of transporting the plant to the factory
- (2) Cost of installing a new power supply required to operate the plant
- (3) Cost of a three-year plant maintenance agreement
- (4) Cost of a three-week training course for staff to operate the plant

A 1 and 3

B 1 and 2

C 2 and 4

D 3 and 4

xiii. Low price for earnings ratio is result of:

- A. low riskier firms
- B. high riskier firms
- C. low dividends paid
- D. high marginal rate

xiv. Which of the following statements about the primary purpose of financial reporting is the most correct?

- A. Provides information that can help with decision making.
- B. The individual needs of users can be satisfied by tailoring of financial reports.
- C. Enables accountability since managers would have to account for resources used.
- D. Identifies a range of existing and potential users' dependant on financial statements to make decisions.

xv. On 1 October 2014, Hody Co. had \$2.5 million of equity share capital (shares of 50 cents each) in issue. No new shares were issued during the year ended 30 September 2015, but on that date, there were outstanding share options which had a dilutive effect equivalent to issuing 1.2 million shares for no consideration. Hody's profit after tax for the year ended 30 September 2015 was \$1,550,000.

In accordance with IAS 33 Earnings Per Share, what is Hoy's diluted earnings per share for the year ended 30 September 2015?

- A. \$0.25
- B. \$0.41
- C. \$0.31
- D. \$0.42

[Total: 30 Marks]

SECTION B

QUESTION 2

(a) During the year to 31 December 2015, a customer started legal proceedings against a company, claiming that one of the food products that it manufactures had caused several members of his family to become seriously ill. The company's lawyers have advised that this action will probably not succeed.

Required:

Should the company disclose this in its financial statements? (5 Marks)

(b) A telecom company has acquired a 2G licence. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the licence is acquired.

Required:

Should borrowing costs on the acquisition of the 2G licence be capitalised until the network is ready for its intended use? (5 Marks)

(c) Define the following term as used in IFRS 16

(i) **Lease modification**

(ii) **Finance Lease**

(iii) **Operating Lease**

(3 Marks)

(d) Your Greens Ltd a Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

Explain how Young Greens Ltd would account for the above circumstances in their books of accounts?

(7 Marks)

[Total: 20 Marks]

QUESTION 3

- (a) All Year Enterprises sold goods to customers but retain the title of the goods till the receipt of money. The goods are normally sold on three months credit and title of the goods also passed to the buyers after receipt of money. All Year Enterprises also give warranty for three months for un-satisfactory performance. At the balance sheet date goods for which title has not been transferred and eligible for warranty are \$1,250,000. The mark up on these goods is 25%. Past experience tells that 80% goods have no claim, 10% returned but can be sold at the original value and remaining 10% have no value at all.

Required:

Calculate the amount of provision All Year Enterprises should show in the financial statements?

(10 Marks)

- (b) The accountant of ABC Limited has come across the following accounting issues while finalizing the financial statements for the year ended December 31, 2018 and sought your opinion being the company IFRS consultant.
- (1) ABC Limited issued a 1 year warranty for defects on a single item of equipment that it delivered to its customer. At the company's year end, the company is being sued by the customer for refusing to replace or repair the item of equipment within the warranty period, as ABC Limited believes the defect is not covered by the warranty, but instead has arisen because of the customer not following the instructions provided in the working manual of the equipment. Kaila and Kaila the company's lawyer has advised ABC Limited that it is more likely that they will be held liable. This would result in the company being forced to replace or repair the equipment plus pay court costs and a fine amounting to approximately \$100,000. Based on past experience with similar items of equipment, the company estimates that there is a 70% chance that the equipment would need to be replaced which would cost \$400,000 and a 30% chance that the repair would only cost about \$15,000.

(2) The company also manufactures small items of equipment which it sells through a retail network. The company sold 12,000 items of this type this year, which also have a 1 year warranty if the equipment fails to perform properly. Based on past experience, 5% of items sold are returned for repair or replacement. In each case, one third of the items returned are able to be repaired at a cost of \$1,000 each, while the remaining two thirds are scrapped and replaced. The manufacturing cost of a replacement item is \$10,000.

(3) ABC Limited has a contract to buy 1,000 Kilograms of copper from a Zambian Company each month for \$3,000 per Kilograms. From each Kilogram of copper ABC Limited make one role of cable. The company also incurs labour and other direct variable costs of \$1,000 per role. Usually company can sell each role of cable for \$4,500 but in late July 2009 the market price falls to \$3,500 per role. The company is considering ceasing production since it thinks that the market may not improve. If the company decides to cancel the copper purchase contract without 2 months' notice it must pay a cancellation penalty of \$150,000 for each of the next two months.

Required:

Discuss the accounting treatment of the above situations? (15 Marks)

[Total: 25 Marks]

QUESTION 4

(a) Nickel Limited is listed company engaged in providing brokerage services in Zimbabwe, Zambia and Malawi stock exchanges and you being audit trainee have come across the following issues during the audit.

i) A litigation has been started against the company during the year by one of its clients being aggrieved that one of the company workers has not acted according to the directions which resulted in a loss of \$2 million. The phone call recorded by the company provides evidence that the company worker has not acted according to the directions. The company has started negotiations for out of court settlement and the said client is insisting for full claim. The company has not provided for the expenses at the year end.

ii) Due to severe losses and low volumes on stock markets the Board of Directors of the company has decided to close down the office at Malawi Stock Exchange and to redundant all the employees at said office. The plan has however, not been announced by the year end. The estimated cost of redundancy is \$4 million.

iii) The company has taken loan from a local bank of \$40 million against creating charge on its investment in shares. Due to heavy losses the company has made a default in payment of interest and principal repayment. According to the agreement the bank has transferred the shares in its name and have filed suit for recovery of the balance amount. The default was made before the yearend however, the bank took the shares in its name and also filed suit for recovery of the balance amount after the year end. The company has not derecognized the investments and loan stands at the original value of \$40 million.

iv) The company has investments in many listed company shares but recorded at their cost of purchase \$20 million during the year. The market value of investment has fallen to \$15.5 million by the year end and has further fallen to \$10.5 million after the year end but before the authorization of financial statements.

v) Due to heavy losses the company has not made contribution to NSSA of \$0.5 million. The amount not contributed is recognized however, the amount of penalty for not making timely contribution of \$15,500 has not been provided for.

Required:

Discuss the appropriate accounting treatment of the above in the Nickel Limited's books of accounts? (15 Marks)

QUESTION 4 (b)

The following events have been identified by the auditors after the year end of the company.

i) One of the cases filed against the company by the income tax department before the Honourable Tribunal has been decided against the company, which has resulted in recognition of additional income tax amounting to \$2 million, but no provision has been made by the company.

ii) During the year company was sued by one of its old employees from terminating the job. The company has created no provision against that case but company's legal advisor is of the

opinion that the case may be decided in the favour of employee and company will be required to pay compensation amounting to \$1.5 million.

iii) The income tax rate has been changed through finance act passed before the yearend but the deferred tax provision is calculated on the old income tax rate. The difference in rate will result in recognition of extra deferred tax expense of \$1.75 million.

iv) The company has issued bonus shares after the year end but the basic and dilution earning per share is based on the old number of shares.

v) One of the operations of the company has been decided by the board of directors to be discontinued being loss making. The decision was taken before the yearend but communicated publically after the yearend. The operation is still presented as part of continuing operations in financial statements.

Required:

Discuss the effect of above events on current year financial statements? (10 Marks)

[Total: 25 Marks]

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