ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTING

DEPARTMENT OF ACCOUNTING AND FINANCE

EXAMINATION PAPER

COURSE CODE	:	CAC203
COURSE TITLE	:	FINANCIAL REPORTING FOR COMPANIES
DURATION	:	3 Hours
LEVEL		2.1
DATE		

INSTRUCTIONS TO CANDIDATES:

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

SECTION A: ANSWER ALL QUESTIONS (Each question carries 2marks)

Select the most appropriate answer

1. Which type of financial instrument has the following characteristics?
   - they do not normally have any voting rights;
   - they usually have a fixed rate of return;
   - they are ranked after unsecured creditors;
   - the return can be suspended by directors, but will have to be paid in later years.

A. Convertible stock
B. Ordinary shares
C. Preference shares
D. Cumulative preference shares

2. Which ONE of the following would require a provision to be created by Bow at the end of its reporting period, 31 October 2020:

A. The government introduced new laws on data protection which come into force on 1 January 2021. Bow's directors have agreed that this will require a large number of staff to be retrained. At 31 October 2020, the directors were waiting on a report they had commissioned that would identify the actual training requirements.
B. At the end of the reporting period, Bow is negotiating with its insurance provider about the amount of an insurance claim that it had filed. On 20 November 2020, the insurance provider agreed to pay $200,000.
C. Bow makes refunds to customers for any goods returned within 30 days of sale, and has done so for many years.
D. A customer is suing Bow for damages alleged to have been caused by Bow's product. Bow is contesting the claim and, at 31 October 2020, the directors have been advised by Bow's legal advisers it is unlikely to lose the case.

3. Dani has the following two legal claims outstanding:
   - A legal action against Dani claiming compensation of $700,000, filed in February 2017. Dani has been advised that it is probable that the liability will materialise.
   - A legal action taken by Dani against another entity, claiming damages of $300,000, started in March 2014. Dani has been advised that it is probable that it will win the case.

How should Dani report these legal actions in its financial statements for the year ended 30 April 2017?

	Legal action against Dani	**Legal action taken by Dani**
A.	Disclose by a note to the accounts	No disclosure
B.	Make a provision	No disclosure
C.	Make a provision	Disclose as a note
D.	Make a provision	Accrue the income

4. **Which of the following costs may not be eligible for capitalization as borrowing costs under IAS 23?**

A. Interest on bonds issued to finance the construction of a qualifying asset.

B. Amortisation of discounts or premiums relating to borrowings that qualify for capitalization.
C. Imputed cost of equity.
D. Exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to interest costs pertaining to a qualifying asset.

5. **Which item listed below does not qualify as an intangible asset?**
A. Computer software.
B. Registered patent.
C. Copyrights that are protected.
D. Notebook computer.

6. **Which of the following items qualify as an intangible asset under IAS 38?**
A. Advertising and promotion on the launch of a huge product.
B. College tuition fees paid to employees who decide to enrol in an executive M.B.A. program at Zimbabwe Ezekiel Guti University (ZEGU) while working with the company.
C. Operating losses during the initial stages of the project.
D. Legal costs paid to intellectual property lawyers to register a patent.

7. Finhai Ltd has a cash-generating unit (CGU) that suffers a large drop in income due to reduced demand for its products. An impairment review was carried out and the recoverable amount of the cash-generating unit was determined at $100m. The assets of the CGU had the following carrying amounts immediately prior to the impairment:

	$
Goodwill	25,000,000
Intangibles	60,000,000
Property, plant and equipment	30,000,000
Inventory	15,000,000
Trade receivables	10,000,000

The inventory and receivables are considered to be included at their recoverable amounts.

What is the carrying amount of the intangibles once the impairment loss has been allocated?
A. $45,000;000 B. $50,000,000 C. $55,000,000 D. $60,000,000

8. If there have been related-party transactions during the year, an entity needs to make, at a minimum, certain disclosures.

Which of the following is not a required minimum disclosure under IAS 24?
A. The amount of the related-party transactions.
B. The amount of the outstanding related-party balances and their terms and conditions along with details of guarantees given and received.
C. The amounts of similar transactions with unrelated (third) parties to establish that comparable related-party transactions have been entered at arm's length.
D. Provisions for doubtful debts related to the amount of outstanding related-party balances and expense recognized during the year in respect of bad or doubtful debts due from related parties.

9. IAS 24 requires disclosure of compensation of key management personnel.
Which of the following would not be considered "compensation" for this purpose?

A. Short-term benefits.
B. Share-based payments.
C. Termination benefits.
D. Reimbursement of out-of-pocket expenses.

10. On 1 January 2016 Beta Co, wine merchants, buys a bottling and labelling machine from Sona Co under a lease which allowed Beta to take control of the machine. The cash price of the machine was $77,100 while the amount to be paid was $100,000. The agreement required the immediate payment of a $20,000 deposit with the balance being settled in four equal annual instalments commencing 31 December 2016. The implicit interest rate is 15% p.a. applicable on the lease calculated on the remaining balance of the liability during each accounting period. Beta incurred additional indirect costs of $26,000, which included $3,100 relocation costs refunded by Sai Co.

Depreciation on the plant is to be provided for at the rate of 20% per annum on a straight line basis assuming a residual value of nil.

How much is the Lease liability on 1 January 2016?

A. $77,100 **B.** $57,000 **C.** $100,000 **D.** $103,100

[Total 20marks]

SECTION B: ANSWER ALL QUESTIONS. (Begin each question on a new page.)

Question 1

a) IAS36 Impairment of Assets, provide guidelines on how to determine the recoverable amount of an asset.

Briefly discuss how the recoverable amount should be calculated and list some of the practical problems experienced by entities when determining the recoverable amount of an asset.

[5marks]

b) Tutsirai ltd acquired an item of plant at a cost of $800,000 on 1 April 2015. The plant had an estimated residual value of $50,000 and an estimated useful life of 5years. Neither of the stated conditions have changed. Tutsirai ltd depreciate its Property, plant and equipment using the straight line method. On 31 March 2017, Tutsirai ltd was informed by a major customer (who purchases goods manufactured by the plant), that it will no longer place orders with Tutsirai ltd. Even before announcing its official position on orders, this major customer has since stopped buying from Tutsirai ltd. Tutsirai ltd has been finding difficulties in finding work contracts for this plant and therefore it has decided to carry out an impairment review.

Tutsirai ltd now estimates that net cash flows to be earned from the plant for the next three years will be:

Year ended:	$
31 March 2018	220,000
31 March 2019	180,000
31 March 2020	170,000

On 31 March 2020, the plant is still expected to be sold for its expected realisable value. Tutsirai ltd has confirmed that there is no market to sell the plant on 31 March 2017. Tutsirai ltd cost of capital is 10%.

Required:
Carry out an impairment review and journalise the ultimate impairment loss of the plant **[10marks]**

c) Tutsirai ltd also owned a 100% subsidiary, Siza-Soza (pvt) ltd that is treated as a Cash Generating Unit (CGU). On 31 March 2017 there was an industrial accident (a gas explosion) that caused damages to some components of Siza-Soza's plant. The assets of Siza-Soza (pvt) ltd immediately before the accident were:

Assets	$
Goodwill	1,800,000
Patent	1,200,000
Factory building	4,000,000
Plant	3,500,000
Receivables	1,000,000
Cash	500,000

As a result of the accident the recoverable amount of Siza-Soza (pvt) ltd is 6,7million. The explosion destroyed to the point of no use an item of plant that had a carrying amount of $500,000. Siza-Soza (pvt) ltd has an open offer from a competitor of 1million for its patent. The receivables and cash are stated at their fair value less costs to sell (net realisable value).

Required:

- Carry out an impairment review clearly showing the carrying amounts of the Siza-Soza (CGU) after the impairment assessment. **[10marks]**
- Journalise the impairment prorated to the individual assets of the CGU. **[5marks]**

[Total 30marks]

Question 2

a) On 1 April 2011, a company issued a convertible loan note of $1,500,000. The loan note carries an effective interest rate of 8%. Each $100 nominal of the loan stock will be convertible in 2016/2019 into the number of ordinary shares set out below:
On 31 December 2016, 200 shares
On 31 December 2017, 120 shares.
On 31 December 2018, 125 shares.
On 31 December 2019, 100 shares.

The following information is also relevant:

1. Issued share capital:

500,000, 10% cumulative irredeemable preference shares of $1 per share.
$1,250,000 in ordinary shares of 25c each.

2. Income taxes are 30%.

3. Trading results for the years ended 31 December 2011 and 2012 were as follows: Profit before interest and tax for 2011 and 2012 was $990,000 and $1,400,000 respectively.

4. Interest on 8% convertible loan note for 2011 was $80,000.

Required:
Calculate the basic earnings per share (EPS) and the diluted earnings per share (DEPS) for both 2011 and 2012.
[20marks]

b) On 1 January 2017, Rambast Company has 4 million ordinary shares in issue and issues options over another million shares. The profit for the year is $500,000. During the year to 31 December 2017 the average fair value of one ordinary share was $6 and the exercise price for the shares under option was $4.

Required:
Calculate Rambast basic EPS and DEPS for the year ended 31 December 2017. **[5marks]**
[Total 25marks]

Question 3

On 1 January 2016 Baccos Co, wine merchants, buys a bottling and labelling machine from Sai Co under a lease which allowed Baccos to take control of the machine. The cash price of the machine was $77,100 while the amount to be paid was $100,000. The agreement required the immediate payment of a $20,000 deposit with the balance being settled in four equal annual instalments commencing 31 December 2016. The implicit interest rate is 15% p.a. applicable on the lease calculated on the remaining balance of the liability during each accounting period. Baccos incurred additional indirect costs of $26,000, which included $3,100 relocation costs refunded by Sai Co.

Depreciation on the plant is to be provided for at the rate of 20% per annum on a straight line basis assuming a residual value of nil.

Required:
a) Journalise the initial recognition of the right-of -use asset and the lease liability. **[6marks]**
b) Journalise subsequent measurement after the first lease payments of both the lease liability and depreciation of the right-of-use asset. **[12marks]**
c) The statement of financial position and statement of profit or loss extracts for the five years. **[7marks]**
[Total 25marks]

END OF EXAMINATION QUESTION PAPER