BINDURA UNIVERSITY OF SCIENCE EDUCATION

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTANCY

PROGRAMMES

Bachelor of Accountancy (Honours) Degree

FINANCIAL ACCOUNTING IIA – AC 201 EXAMINATION PAPER

DURATION: 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. Answer all questions in section A and section B
2. Cell phones are not allowed in the examination
3. Start each question on a fresh page

SECTION A : 30 MARKS

Information below is relevant to questions 1-4

The financial statements of P Ltd for the year ended 31 December 2022 are being prepared and the accountant has requested your advice on dealing with the following issues.

(i) P Ltd has an administration building which it no longer needs. On 1 July 2022 P Ltd entered into an agreement to lease the building out to another company. The building cost \$600 000 on 1 January 2014 and is being depreciated over 50 years, based on the IAS 16 cost model. P Ltd applies the fair value model under IAS 40 Investment Property and the fair value of the building was judged to be \$800 000 on 1 July 2022. Its value had not changed at 31 December 2022.

(ii) P Ltd owns another building which has been leased out for a number of years. It had a fair value of \$550 000 on 31 December 2021 and \$740 000 on 31 December 2022.

(iii) P Ltd owns a retail business which has suffered badly during the recession. P Ltd treats this business as a separate cash generating unit.

(1) What is the amount of the revaluation surplus that will be recognized in respect of the building in (i)?

A. \$200 000

B. \$314 000

C. \$308 000

D. Nil

(2) In respect of the buildings in (ii) how will the increase in value from \$550 000 to \$740 000 be accounted for?

A. Credit to profit or loss

B. Credit to the revaluation surplus

C. Credit to retained earnings

D. Credit to an investment property reserve.

(3) When an impairment review is carried out, a potentially impaired asset is measured at what amount?

A. Fair value

B. Value in use

C. Recoverable amount

D. Carrying amount

(4) What will be the carrying amount of the inventory after the impairment loss in (iii) has been accounted for?

A. $64 000

B. $70 000

C. $Nil

D. $65 000

(5) Tom is developing a new product and expects to be able to capitalize the costs. Which one of the following would preclude capitalization of the costs.

A. Development of the product is not yet complete.

B. No patent has yet been registered in respect of the product.

C. No sales contracts have yet been signed in relation to the product

D. It has not been possible to reliably allocate costs to development of the products.

(6) A company had $20 million of capitalized development expenditure at cost brought forward on 1 October 2021 in respect of products currently in production and a new project began on the same date. The research stage of the new project lasted until 31 December 2021 and incurred $1 400 000 of costs. From that date the project incurred development costs of $800 000 per month.

On 1 April 2022 the directors became confident that the project would be successful and yield a profit well in excess of costs. The project was still in development on 30 September 2022. Capitalized development expenditure is amortized at 20% per annum using the straight line method.

What amount will be charged to profit or loss for the year ended 30 September 2022 in respect of research and development costs?

A. $8 280 000

B. $6 880 000

C. $7 800 000

D. $3 800 000

(7) Which one of the following internally-generated items may be eligible for capitalization as intangible assets in accordance with IAS 38 Intangible Assets?

A. A customer list

B. A pre-production prototype

C. Goodwill

D. The cost of researching new material

Information below is relevant to questions 8-12

Mukanya is a listed company. It has been considering the accounting treatment of its intangible assets and hows it affects financial statements for the year ended 31 March 2022.

(i) On 1 October 2018 Mukanya acquired Shoko a small company that specializes in pharmaceutical drug research and development. The purchase consideration was by way of a share exchange and valued at $35 million. The fair value of Shoko's net assets was $15 million (excluding any items referred to below).
Shoko owns a patent for an established successful drug that has a remaining life of eight years. A firm of specialist advisors, has estimated the current value of this patent to be $10 million, however the company is awaiting the outcome of clinical trials where the drug has been tested to treat a different illness. If the trials are successful, the value of the drug is then established to be $15 million. Also included in the company's statement of financial position is $2 million for medical research that has been conducted on behalf of a client.

(ii) Mukanya has developed and patented a new drug which has been approved for clinical use. The costs of developing the drug were $12 million. Based on early assessments of its sales success. Shoko have estimated its market value at $20 million which can be taken as a reliable measurement.

(iii) Mukanya's manufacturing facilities have recently received a favorable inspection by government medical scientists. As a result of this the company has been granted an exclusive five-year license to manufacture and distribute a new vaccine. Although the license had no direct cost to Mukanya, its directors feel its granting is a reflection of the company's standing and have asked Ncube to value the license. Accordingly they have placed a value of $10 million on it.

(iv) In the current accounting period, Mukanya has spent $3 million sending its staff on specialist training courses. Whilst these courses have been expensive, they have led to a marked improved in production quality and staff now need less supervision. This in turn has led to an increase in revenue and cost reduction. The directors of Mukanya believe these benefits will continue for at least three years and wish to treat the training costs as an asset.

(8) Which of the following items should be recognized as intangible assets-

(i) Patent for new drug

(ii) License for new vaccine

(iii) Specialist training

A. (i) and (ii)

B. (ii) and (iii)

C. (i) and (iii)

D. (i) only

(9) Which of the following is one of the criteria for the recognition of development costs as an intangible asset?

A. The asset has been completed and is available for sale or use.

B. It is possible that the asset can be sold or used.

C. The proceeds from sale or use of the asset can be reliably measured

D. The asset will generate probable future economic benefits

(10)IAS 38 gives examples of activities that would be regarded as research and therefore not eligible for recognition as an intangible asset. Which one of the following would be an example of research costs?

A. The design and construction of chosen alternative products or processes

B. The design of pre-production prototypes and models

C. The design of possible new or improved product or process alternatives

D. The design, construction and operation of a pilot plant.

(11) At what amount should the patent acquired from Shoko be valued at 31 March 2022?

A. $10 000 000

B. $93 75000

C. $15 000000

D. $ Nil

(12) How should Mukanya treat the goodwill arising on its acquisition of Shoko?

A. It should be capitalized and amortized over 20 years

B. It should be capitalized and reviewed for impairment every year

C. It should be capitalized and reviewed for impairment every five years

D. It should be written off to retained earnings

(13) A cash-generating unit comprises the following assets:

	$000
Buildings	700
Plant and equipment	200
Goodwill	90
Current assets	20
Total	**1 010**

One of the machines, carried at $40 000 is damaged and will have to be scrapped. The recoverable amount of the cash-generating unit is estimated at $750 000.

What will be the carrying amount of the building when the impairment loss has been recognized?

A. \$597 000

B. \$577 000

C. \$594 000

D. \$548 000

(14) What is the recoverable amount of an asset?

A. Its current market value less costs of disposal

B. The lower of carrying amount and value in use.

C. The higher of fair value less costs of disposal and value in use

D. The higher of carrying amount and market value

(15) A machine has a carrying amount of \$85 000 at the year end of 31 March 2022. Its market value is \$78000 and costs of disposal are estimated at \$2 500. A new machine would cost \$150 000. The company which owns the machine expects it to produce net cashflows of \$30 000 per annum for the next three years. The company has a cost of capital of 8%. What is the impairment loss on the machine to be recognized in the financial statements at 31 March 2022?

A. \$7 687

B. \$9 500

C. \$1 667

D. \$2 200

SECTION B: 70MARKS

QUESTION 1

The following balances appeared in the books of G Ltd for the financial year ended 30 June:

	2022	2021
	$	$
Property, plant and Equipment	4 175 000	2 500 000
Investments	700 000	550 000
Inventory	50 000	63 000
Trade and other receivables	300 000	250 000
Prepaid expenses	8 000	10 000
Dividends receivable	15 000	-
Cash and cash equivalents	-	85 000
Cost of sales	700 000	480 000
Administrative expenses	175 000	120 000
Distribution expenses	100 000	95 000
Other expenses (including depreciation)	450 000	85 000
Finance cost	20 000	20 000
Income tax expense	166 000	133 000
Dividends declared and paid	250 000	50 000
	7 109 000	4 441 000
Ordinary share capital $1 each	2 500 000	1 500 000

Share premium	380 000	400 000
Surplus on revaluation of land	150 000	100 000
Retained earnings beginning of year	405 000	143 000
10% long term loan	180 000	200 000
Deferred tax	8 000	8 000
Accumulated depreciation (PPE)	803 000	700 000
Short term portion of long term loan	20 000	-
Tax payable	65 000	60 000
Dividends payable	125 000	50 000
Trade and other payables	200 000	35 000
Accrued interest on long term loan	5 000	-
Bank overdraft	428 000	-
Sales (credit)	1 750 000	1 200 000
Profit on sale of equipment	15 000	-
Income from investments – dividends	75 000	45 000
	7 109 000	4 441 000

Additional information:

1. On 1 May 2022, the company issued capitalization shares at par to the ordinary shareholders in the ratio of 1 share for every 5 shares held. The share premium account was utilized for this purpose.
2. On 1 June 2022, ordinary share were issued to the public at a premium of 40%.

3. During the financial year, the following changes took place in non-current assets:

	Total	Land	Buildings	Equipment
	$	$	$	$
Carrying amount beginning of year	1 800 000	800 000	150 000	850 000
Cost	2 500 000	800 000	200 000	1 500 000
Accumulated depreciation	(700 000)	-	50 000	650 000
Purchase at cost	2 125 000	-	-	2 125 000
Disposal at carrying amount	(200 000)	-	-	(200 000)
Revaluation during the year	50 000	50 000	-	-
Depreciation for the year	(403 000)	-	(3 000)	(400 000)
Carrying amount end of year	3 372 000	850 000	147 000	2 375 000
Cost / Valuation	4 175 000	850 000	200 000	3 125 000
	(803 000)	-	(53 000)	(750 000)

One million dollars ($1 000 000) of the purchases of plant and equipment represent replacements of equipment disposed of.

4. The long term loan was incurred on 1 January 2016 and the capital portion is repayable in ten equal annual installments starting on 31 July 2022.

5. New investments were purchased during the year.

Required:

Prepare a statement of cash flow of G Limited for the year ending 30 June 2022 using the direct method

(30 marks)

QUESTION 2

The accountant of W Ltd has prepared the following lists of account balances as at 31 December 2022.

	$000	$000
50c Ordinary shares (fully paid)		450
10% loan notes (secured)		200
Retained earnings (01-01-2022)		242
General reserve 1-1-22		171
Land and Buildings 1-1-22 (cost)	430	
Plant and Machinery 1-1-22 (cost)	830	
Accumulated depreciation:		
Buildings 1-1-22		20
Plant and Machinery 1-1-22		222
Inventory 1-1-22	190	
Sales		2695
Purchases	2152	
Ordinary dividend	15	
Loan note interest	10	
Wages and salaries	254	
Light and heat	31	
Sundry expenses	113	

Suspense account		135
Trade accounts receivable	179	
Trade accounts payable		195
Cash	126	

Additional information:

(a) Sundry expenses include $9 000 paid in respect of insurance for the year ending 30 September 2023. Light and heat does not include an invoice of $3 000 for electricity for the 3 months ending 2 January 2023, which was paid in February 2023. Light and heat also includes $20 000 relating to salesman`s commission.

(b) The suspense account is in respect of the following items:

	$000
Proceeds from the issue of 100 000 ordinary shares	120
Proceeds from sale of plant	300
	420
Less consideration for the acquisition of M Ltd	285
	135

(c) The net assets of M Ltd were purchased on 3 March 2022. Assets were valued as follows:

	$000
Equity investments	231
Inventory	34
	265

All the inventory acquired was sold during 2022. The equity investments were still held by W Ltd at 31 December 2022. Goodwill has not been impaired in value.

(d) The property was acquired some years ago. The buildings element of the cost was estimated at $100 000 and the estimated useful life of the assets were 50 years at the time of purchase. As at 31 December 2022 the property is to be revalued at $800 000.

(e) The plant which was sold had cost $350 000 and had a carrying amount of $274 000 as on 01 January 2022. $36 000 depreciation is to be charged on plant and machinery for 2022.

(f) The management wish to provide for:

i) Loan note interest due

ii) A transfer to general reserve of $16 000

iii) Audit fees of $4 000

(g) Inventory as at 31 December 2022 was valued at $220 000

(h) Taxation is to be ignored.

Required:

Prepare the statement of profit or loss and other comprehensive income of W Limited for the year-ended 31 December 2022 and the statement of financial position as at that date. (25 marks)

QUESTION 3

At the date of incorporation of S Limited on 1 July 2020, R Ltd acquired 80 000 ordinary shares of 50c each in S Ltd.

The following represented the trial balances of R Ltd and S Ltd at 30 June 2022.

	R Ltd	S Ltd
	$	$
Credits		
Ordinary shares of 50c each	200 000	50 000
Retained earnings	70 000	55 000
Trade and other payables	90 000	50 000
Accumulated depreciation	86 000	64 000

Revaluation of land and buildings	50 000	24 000
Interest bearing borrowings - R Ltd	-	100 000
Bank overdraft – W Bank	100 000	-
	596 000	343 000
Debits		
Land and buildings at valuation	200 000	67 000
Plant and equipment at cost price	110 000	170 000
Trade and other receivables	20 000	26 000
Bank – R Bank	-	46 000
Inventories	68 000	34 000
Loan – S Ltd	150 000	-
Investment in S Ltd of fair value	48 000	-
	596 000	343 000

Additional information

1. Since R Ltd acquired its interest in S Ltd, R Ltd has purchased all its inventories from S Ltd. S Ltd sells all its inventories at cost plus 25%. On 30 June 2022 R Ltd had $80 000 inventories on hand.
2. R Ltd posted a cheque of $50 000 to S Ltd on 25 June 2022. The cheque got lost in the post and the cheque was cancelled.
3. S Ltd bought a machine from R Ltd on 30 June 2022. R Ltd made a profit of $30 000 on the sale. Both companies depreciate plant and equipment at 20% on the straight line method.

Required:

Prepare R Ltd and its subsidiary's consolidated statement of Financial Position as at 30 June 2022. **(15 Marks)**

END OF PAPER