BINDURA UNIVERSITY OF SCIENCE EDUCATION

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTANCY

PROGRAMME:
Bachelor of Accountancy (Honours) Degree
Bachelor of Business Administration (Honours) Degree in Police and Security
Studies

JUN 2024

CORPORATE REPORTING II (AC411)

EXAMINATION PAPER

DURATION: 3 HOURS

INSTRUCTIONS TO CANDIDATES:

1. You should answer ALL questions.
    a. Section A multiple choice each question carrying 2 marks b. Section B structured questions
2. No cell phones are allowed in the examination venue.
3. Use of silent and non-programmable calculators is allowed.

SECTION A - 30 MARKS

The following scenario relates to questions 1-5.

During the year ended 31 December 2021, Lindani Ltd built an extension to its head office. The costs associated with the construction of the head office extension are as follows:

	$m
Land acquisition	10·0
Fees for environmental certifications and building permits	0·5
Architect and engineer fees	1·0
Construction material and labour costs (including unused materials)	6·6

At 30 September 2021, the date when the head office extension became available for use, the cost of unused materials on site amounted to $0·5m. At that date, the total borrowing costs incurred on a loan which was used to specifically finance the head office extension amounted to $0·8m.

Lindani Ltd also acquired 100% interest in Kusile Ltd on 1 January 2021. The carrying amount of the assets of Kusile Ltd in the consolidated financial statements of the Lindani group at 31 December 2021; immediately before an impairment review were as follows:

	$m
Goodwill	1·4
Brand name	2·0
Property, plant and equipment	6·0
Current assets (at recoverable amount)	2·4

	11·8

The recoverable amount of Kusile Ltd was estimated at $9·6m at 31 December 2021 and the impairment of the investment in Kusile Ltd was deemed to be $2·2m.

1. **For the year ended 31 December 2021, how much should be capitalised in respect of the construction of the extension to the head office building?**

   A.
   $18·4m
   B.
   $17·6m

C.
$18·9m
D.
$18·1m

2. Lindani Ltd incurred further expenditure on the head office extension after it had been completed.

Which of the following would qualify as capital expenditure?

A. Property insurance premiums incurred
B. Installation of new office fixtures and fittings
C. Marketing costs telling the public that the head office extension is operational
D. Maintenance and relocation of computers and related office equipment

3. **At 31 December 2022, the directors of Lindani Ltd decide to adopt the revaluation model of IAS 16 Property, Plant and Equipment for Lindani Ltd's property.**

In accordance with IAS 16, which of the following statements is FALSE?

A. In subsequent years, the depreciation will be based on the revalued amount of the head office building as opposed to its cost
B. Any revaluation gain on the head office building is recognised in other comprehensive income and any revaluation loss is recognised in profit or loss
C. Each component part of the head office building is revalued separately
D. The residual value and the useful life of the head office building must be reviewed each year

4. **Assuming Kusile Ltd represents a cash generating unit, what is the carrying amount of the brand at 31 December 2021 following the impairment review?**

A.
$1·2m B.
$1·45m
C.
$1·73m
D.
$1·8m

5. **Which, if any, of the following statements regarding impairment reviews is/are correct?**

(1) At the end of each reporting period, an entity should assess if there is any indication that assets have been impaired
(2) Annual impairment reviews are required on all intangible assets with indefinite lives

A. 1 only
B. 2 only

C. Both 1 and 2
D. Neither 1 nor 2

The following scenario relates to questions 6-10.

The following is an extract from Daily Ltd's trial balance as at 31 December 2021:

	Debit	Credit
	$m	$m
Inventory at 31 December 2021	8·6	
Trade receivables	6·2	
5% loan notes		9·0

The inventory count was completed on 31 December 2021, but two issues have been noted. First, products with a sales value of $0·6m had been incorrectly excluded from the count. Second, items costing $0·2m which had been included in the count were damaged and could only be sold for 50% of the normal selling price. Daily Ltd makes a mark-up of 50% on both of these items.

Daily Ltd entered into a factoring agreement with Finaid Ltd on 31 December 2021. In accordance with the agreement, Daily Ltd sold trade receivables with a carrying amount of $6·2m to Finaid Ltd for $6m. Under the terms of the factoring agreement, after six months Finaid Ltd will return any unpaid receivables to Daily Ltd for collection. Finaid Ltd will also charge Daily Ltd a fee of 5% of any uncollected balances at the end of each month.

The 5% loan notes were issued for $9m on 1 July 2021. Daily Ltd incurred issue costs of $0·5m associated with this, which have been expensed within finance costs. The loan note interest is payable each 30 June and the loan note is repayable at a premium, giving them an effective interest rate of 8%.

6. **In accordance with IAS 32 *Financial Instruments: Presentation*, which of the items in the trial balance would be classified as financial instruments?**
   A. Closing inventory and trade receivables only
   B. 5% loan notes only
   C. Trade receivables and 5% loan notes only
   D. Closing inventory, trade receivables and 5% loan notes

7. **What is the correct carrying amount of inventory to be recognised in Daily Ltd's financial statements as at 31 December 2021?**

   A. $8·95m
   B. $9·0m
   C. $8·9m
   D. $9·15m

8. In an attempt to improve reported profit, the directors of Daily Ltd want to change the valuation method of inventory from first in first out (FIFO) to an average cost method.

Which, if any, of the following statements regarding the potential change in inventory valuation is/are correct?

(1) The change will represent a change in accounting estimate
(2) The financial statements will be adjusted prospectively

A. 1 only
B. 2 only
C. Both 1 and 2
D. Neither 1 nor 2

9. **Which of the following statements regarding the factoring arrangement Is NOT true?**

A. \$6m received should be recorded in the liabilities of Daily Ltd at 31 December 2021.
B. \$0·2m should be expensed in Daily Ltd's statement of profit or loss for the year ended 31 December 2021
C. A total of the 5% monthly fee should be expensed in Daily Ltd's statement of profit or loss for the year ended 31 December 2022
D. The receivables will remain as an asset in the financial statements of Daily Ltd at 31 December 2021.

10. **In respect of the 5% loan notes, how much should be expensed within Daily Ltd's statement of profit or loss for the year ended 31 December 2021?**

A. \$0·68m
B. \$0·45m
C. \$0·72m
D. \$0·34m

11. **Goodwill does not fall within the IAS38 definition of an intangible asset because:**

A. It is not separable
B. It may not generate future economic benefits
C. It is a monetary asset
D. None of the above

12. **The revaluation model cannot be used for the measurement of an intangible asset unless:**

A. The fair value of the asset is determined by a professional valuer
B. There is an active market in that type of asset
C. The revaluation model is also used for tangible assets
D. The asset is revalued every year

13. On 31 December 2016, a company acquires an intangible asset for \$50,000. The asset is revalued at \$42,000 on 31 December 2017 and \$57,000 on 31 December 2021. The company prepares financial statements to 31

December each year and uses the revaluation model in relation to this class of intangible assets. The correct accounting treatment of each revaluation in the statement of comprehensive income is as follows:

A. 2017 Expense $8,000
2021 Income $8,000 Other comprehensive income $7,000

B. 2017 Expense $8,000
2021 Other comprehensive income $15,000

C. 2017 Negative other comprehensive income $8,000
2021 Other comprehensive income $15,000

D. 2017 Expense $8,000
2021 Income $15,000

14. An impairment loss is:

A. The amount by which the carrying amount of an asset exceeds its market value
B. The amount by which the carrying amount of an asset exceeds its Recoverable amount
C. The amount by which the recoverable amount of an asset exceeds its carrying amount
D. The amount by which the recoverable amount of an asset exceeds its written down value

15. An asset is expected to generate cash inflows of $20,000 per annum for each of the next three years and then to be scrapped. These cash inflows will occur at the end of each year. The asset will generate no cash outflows. Using a discounting rate of 10% per annum, what is the asset's value in use?

A. $49,720
B. $54,000
C. $60,000
D. $54,540

SECTION B-70

MARKS Question 1

Part A

William is a public limited company and would like advice in relation to the following transaction.

William owned a building on which it raised finance. William sold the building for $6 million, its fair value, to a finance company on 1 June 2021 when the carrying amount was $3.6 million. The same building was leased back from the finance company for a period of 20 years. The remaining useful life of the building is 25 years. The lease rentals for the period are $441,000 payable annually in arrears. The interest rate implicit in the lease is 7%. The present value of the lease payments is $5 million. The transaction constitutes a sale in accordance with IFRS 15 Revenue from Contracts with Customers.

Required:

Advise William on how to account for the above transaction for the year ended 31 May 2022. (8 marks)

Part B

Gasnature has entered into a ten-year contract with Agas for the purchase of natural gas.

Gasnature has made an advance payment to Agas for an amount equal to the total quantity of gas contracted for ten years which has been calculated using the forecasted price of gas. The advance carries interest of 6% per annum, which is settled by way of the supply of extra gas.

Fixed quantities of gas have to be supplied each month and there is a price adjustment mechanism in the contract whereby the difference between the forecasted price of gas and the prevailing market price is settled in cash monthly. If Agas does not deliver gas as agreed, Gasnature has the right to claim compensation at the current market price of gas. Gasnature wishes to know whether the contract with Agas should be accounted for under IFRS 9- *Financial Instruments.* (6 marks)

Part C

Alexandra, a public limited company, designs and manages business solutions and infrastructures.

In November 2020, Alexandra defaulted on an interest payment on an issued bond loan of $100 million repayable in 2025. The loan agreement stipulates that such default leads to an obligation to repay the whole of the loan immediately, including accrued interest and expenses. The bondholders, however, issued a waiver postponing the interest payment until 31 May 2021. On 17 May 2021, Alexandra felt that a further waiver was required, so requested a meeting of the bondholders and agreed a further waiver of the interest payment to 5 July 2021, when Alexandra was confident it could make the payments. Alexandra classified the loan as long-term debt in its statement of financial position at 30 April 2021 on the basis that the loan was not in default at the end of the reporting period as the bondholders had issued waivers and had not sought redemption.

Required:

i) Explain, with reference to the principles of relevant IFRSs, the appropriate accounting treatment for the above issue in Alexandra's financial statements for the year ended 30 April 2021. (5 marks)

ii) Discuss, in respect of the above issue, any ethical implications and any potential impact on the analysis of Alexandra's financial statements by its investors. (5 marks)

[Total: 25 marks]

Question 2

Part A

ZMC, a public limited company, operates a funded defined benefit plan for its employees. The plan provides a pension of 1% of the final salary for each year of service. The cost for the year is determined using the projected unit credit method. This reflects service rendered to the dates of valuation of the plan and incorporates actuarial assumptions primarily regarding discount rates, which are based on market yields of high quality corporate bonds. The expected average remaining working lives of employees is twelve years.

The directors have provided the following information about the defined benefit plan for the current year (year ended 31 October 2022):

(i) The actuarial cost of providing benefits in respect of employees' service for the year to 31 October 2022 was $40 million. This is the present value of the pension benefits earned by the employees in the year.

(ii) The pension benefits paid to former employees in the year were $42 million.

(iii) ZMC should have paid contributions to the fund of $28 million. Because of cash flow problems, $8 million of this amount had not been paid at the financial year end of 31 October 2022.

(iv) The present value of the obligation to provide benefits to current and former employees was $3,000 million at 31 October 2021 and $3,375 million at 31 October 2022.

(v) The fair value of the plan assets was $2,900 million at 31 October 2021 and $3,170 million (including contributions owed by ZMC) at 31 October 2022. The actuarial gains recognised at 31 October 2021 were $336 million.

With effect from 1 November 2021, the company had amended the plan so that the employees were now provided with an increased pension entitlement. The benefits became vested immediately and the actuaries computed that the present value of the cost of these benefits at 1 November 2021 was $125 million. The discount rates and expected rates of return on the plan assets were as follows;

	31 October 2021	31 October 2022
Discount rate	6%	7%
Expected rate of return on plan assets	8%	9%

The company has recognised actuarial gains and losses in profit or loss up to 31 October 2021 but now wishes to recognise such gains and losses outside profit or loss in other comprehensive income.

Required:

a) Show the amounts which will be recognised in the statement of financial position and the single statement of profit or loss and other comprehensive income for the year ended 31 October 2022, under IAS 19 *Employee benefits*, and the movement in the net liability in the statement of financial position. (16 marks)

Part B

William operates a defined benefit pension plan for its employees. Shortly before the year end of 31 May 2022, William decided to relocate a division from one country to another, where labour and raw material costs are cheaper. The relocation is due to take place in December 2022. On 13 May 2022, a detailed formal plan was approved by the board of directors.

Half of the affected division's employees will be made redundant in July 2022, and will accrue no further benefits under William's defined benefit pension plan. The affected employees were informed of this decision on 14 May 2022. The resulting reduction in the net pension liability due the relocation is estimated to have a present value of $15 million as at 31 May 2022.

Total relocation costs (excluding the impact on the pension plan) are estimated at $50 million.

Required:

William requires advice on how to account for the relocation costs and the reduction in the net pension liability for the year ended 31 May 2022. (7marks)

[Total: 25 marks]

Question 3

Canto Co is a company which manufactures industrial machinery and has a year end of 28 February. The directors of Canto require advice on the following issues:

Part A

On 1 March 2019, Canto acquired a property for $15 million, which was used as an office building. Canto measured the property on the cost basis in property, plant and equipment. The useful life of the building was estimated at 30 years from 1 March 2019 with no residual value. Depreciation is charged on the straight-line basis over its useful life. At acquisition, the value of the land content of the property was thought to be immaterial.

During the financial year to 28 February 2022, the planning authorities approved the land to build industrial units and retail outlets on the site. During 2022, Canto ceased using the property as an office and converted the property to an industrial unit. Canto also built retail units on the land during the year to 28 February 2022. At 28 February 2022, Canto wishes to transfer the property at fair value to investment property at $20 million. This valuation was based upon other similar properties owned by Canto. However, if the whole site were sold including the retail outlets, it is estimated that the value of the industrial units would be $25 million because of synergies and complementary cash flows.

The directors of Canto wish to know whether the fair valuation of the investment property is in line with International Financial Reporting Standards and how to account for the change in use of the property in the financial statements at 28 February 2022. (8 marks)

Part B

On 28 February 2022, Canto acquired all of the share capital of Binlory, a company which manufactures and supplies industrial vehicles. At the acquisition date, Binlory has an order backlog, which relates to a contract between itself and a customer for ten industrial vehicles to be delivered in the next two years.

In addition, Binlory requires the extensive use of water in the manufacturing process and can take a pre-determined quantity of water from a water source for industrial use. Binlory cannot manufacture vehicles without the use of the water rights. Binlory was the first entity to use water from this source and acquired this legal right at no cost several years ago. Binlory has the right to continue to use the quantity of water for manufacturing purposes but any unused water cannot be sold separately. These rights can be lost over time if non-use of the water source is demonstrated or if the water has not been used for a certain number of years. Binlory feels that the valuation of these rights is quite subjective and difficult to achieve.

The directors of Canto wish to know how to account for the above intangible assets on the acquisition of Binlory. (7 marks)

Part C

Canto acquired a cash-generating unit (CGU) several years ago but, at 28 February 2020, the directors of Canto were concerned that the value of the CGU had declined because of a reduction in sales due to new competitors entering the market. At 28 February 2020, the carrying amounts of the assets in the CGU before any impairment testing were:

	$m
Goodwill	3
Property, plant and equipment	10
Other assets	19
Total	32

The fair values of the property, plant and equipment and the other assets at 28 February 2020 were $10 million and $17 million respectively and their costs to sell were $100,000 and $300,000 respectively.

The CGU's cash flow forecasts for the next five years are as follows:

Date year ended	*Pre-tax cash flow*	*Post-tax cash flow*
	$m	$m
28 February 2020	8	5
28 February 2021	7	5
28 February 2022	5	3
28 February 2023	3	1.5
28 February 2024	13	10

The pre-tax discount rate for the CGU is 8% and the post-tax discount rate is 6%. Canto has no plans to expand the capacity of the CGU and believes that a reorganisation would bring cost savings but, as yet, no plan has been approved.

The directors of Canto need advice as to whether the CGU's value is impaired. The following extract from a table of present value factors has been provided.

(8 marks)

Year	*Discount rate 6%*	*Discount rate 8%*
1	0.9434	0.9259
2	0.8900	0.8573
3	0.8396	0.7938
4	0.7921	0.7350
5	0.7473	0.6806

Required

Advise the directors of Canto on how the above transactions should be dealt with in its financial statements with reference to relevant International Financial Reporting Standards.

******************************* *END OF EXAM* ***************************