National University of Science and Technology

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING

SECOND SEMESTER EXAMINATION PAPER: 2011/2012

DATE:	**MAY 2012**
SUBJECT:	**FINANCIAL ACCOUNTING IIB: CAC 2201**
TIME ALLOWED:	**THREE (3) HOURS**
MARKS:	**100**

INSTRUCTIONS TO CANDIDATES

1. Answer any four (4) questions
2. Use the examination book provided
3. Use black or blue pen
4. Begin each question on a new page and
5. Submit all answer books

QUESTION ONE [25 marks]

Highveldt, a public listed company, acquired 75% of Samson's ordinary shares on 1 April 2010. Highveldt paid an immediate $3·50 per share in cash and agreed to pay a further amount of $108 million on 1 April 2011. Highveldt's cost of capital is 8% per annum. Highveldt has only recorded the cash consideration of $3·50 per share.

The Summarised Statements of Financial Position of the two companies at 31 March 2011 are shown below:

		Highveldt		**Samson**
	$million	$million	$million	$million
Tangible non current assets		420		320
Development costs		nil		40
Investments		300		20
		720		380
Current assets		133		91
Total assets		**853**		**471**
Equity and Liabilities:				
Ordinary share capital (1$ each)		270		80
Reserves:				
Share premium		80		40
Revaluation Reserve		45		nil
Retained earnings-01/04/10	160		134	
-year to 31/03/11	190	350	76	210
		745		330
Non current liabilities				
10 % intercompany loans		nil		60
Current liabilities		108		81
Total equity and liabilities		**853**		**471**

Additional information:

- **(i)** Highveldt has a policy of revaluing land and buildings to fair value. At the date of acquisition Samson's land and buildings had a fair value $20 million higher than their book value and at 31 March 2011 this had increased by a further $4 million (ignore any additional depreciation).
- **(ii)** Included in Highveldt's investments is a loan of $60 million made to Samson at the date of acquisition. Interest is payable annually in arrears. Samson paid the interest due for the year on 31 March 2011, but Highveldt did not receive this until after the year end. Highveldt has not accounted for the accrued interest from Samson.
- **(iii)** Samson had established a line of products under the brand name of Titanware. Acting on behalf of Highveldt, a firm of specialists, had valued the brand name at a value of $40 million with an estimated life of 10 years as at 1 April 2010. The brand is not included in Samson's statement of financial position.
- **(iv)** Samson's development project was completed on 30 September 2010 at a cost of $50 million. $10 million of this had been amortised by 31 March 2011. Development costs capitalised by Samson at the date of acquisition were $18 million. Highveldt's directors are of the opinion that Samson's development costs do not meet the criteria in IAS 38 'Intangible Assets' for recognition as an asset.
- **(v)** Samson sold goods to Highveldt during the year at a profit of $6 million, one-third (1/3) of these goods were still in the inventory of Highveldt at 31 March 2011.
- **(vi)** An impairment test at 31 March 2011 on the consolidated goodwill concluded that it should be written down by $22 million. No other assets were impaired.

Required:

(a) Calculate the following figures as they would appear in the consolidated Statement of financial position of Highveldt at 31 March 2011:

(i) Goodwill; **[8]**

(ii) Non controlling interest; **[4]**

(iii) The following consolidated reserves: share premium, revaluation reserve and retained earnings. **[8]**

Note: show your workings

(b) Explain why consolidated financial statements are useful to the users of financial statements. **[5]**

QUESTION TWO [25 Marks]

Patrick Ltd purchased 75% (and control) of Sally Ltd on 1 January 2008. At that date the retained earnings of Sally Ltd was $50 000, the revaluation reserve was $20 000, and the share capital $100 000. Sally's assets and liabilities were considered to be fairly valued with the exception of land that was considered to be undervalued by $30 000, and plant that was considered to have a fair value of $240 000. The plant had a cost of $320 000 and accumulated depreciation of $120 000 at the acquisition date. Both Patrick and Sally agreed that the estimated remaining useful life of the plant was 5 years, with no residual value. You can assume that no goodwill was paid at acquisition of the investment in Sally. Patrick has always consolidated those entities over which it has control.

Sally Ltd has always applied the revaluation model to its land, and processed the following journal entry at 30 June 2010, its next revaluation date:

Dr	Land	$60 000	
Cr	Revaluation Reserve		$60 000

This was the only revaluation since the acquisition date, and there were no revaluations in any of the entities during the current year.

Patrick advanced $120 000 as a loan to Sally on 1 April 2011, the conditions of the loan stipulated that the amount is repayable in full on 1 April 2015 and interest is charged at 8% per annum. You can assume that both entities recognised the loan/advance and interest correctly in their respective financial statements. In addition, Patrick resolved to guarantee the bank overdraft balance of Sally (amounting to $50 000).

Extracts from the trial balances at 31 December 2011

	Patrick	**Sally**
	$	**$**
Retained earnings at 1 January 2011	(190 000)	(130 000)
Share capital	(150 000)	(100 000)
Revaluation reserve	(40 000)	(80 000)
Current year profit after tax	(120 000)	(90 000)
Dividends declared and paid	20 000	30 000

<u>REQUIRED :</u>

Prepare the **pro-forma journal entries** to consolidate Patrick's interest in Sally in the group financial statements for the year ended 31 December 2011. **[25]**

QUESTION THREE [25 Marks]

The following are extracts from the income statements and the statements of financial position of World Explorers Limited in respect of the financial years 2010 and 2011:

a) Extract from the statement of comprehensive income of World Explorers Limited for the year ended 30 June:

	2011	**2010**
	$000	**$000**
Sales	1 290 000	980 000
Cost of goods sold	853 500	588 000
Interest expense	20 000	25 000
Profit before tax (*after interest)*	292 500	193 000
Net profit after tax	204 750	135 100

b) Extract from the Statement of financial position of World Explorers Limited for the year ended 30 June:

	2011	**2010**
	$000	**$000**
Ordinary share capital *(Par value $2)*	292 000	150 000
Accumulated profit – beginning of year	425 000	275 000
Long-term debt (*10 % p.a.)*	200 000	250 000
Inventory	200 000	160 000
Accounts receivable	193 800	167 200
Cash	44 000	38 000
Accounts payable	214 750	120 000
Non current assets at carrying value (net book value)	1 131 750	795 000

c) Industry averages for the year ended 30 June 2011.

Current ratio	1.75: 1
Acid test ratio	1.25: 1
Debt ratio	52 %
Days inventory on hand	65 days
Debtors' collection period	80 days
Gross margin	32 %
Net profit margin	10 %

NB.You can assume that 75% of all sales are on credit and all purchases are on credit.

REQUIRED:

(i)

(a) Calculate the gross profit percentage on sales for 2010 and 2011 **[1]**

(b) Has the gross profit percentage changed? Provide TWO reasons that could cause the gross profit percentage to change. **[2]**

(c) Briefly explain what the gross profit percentage in 2011 means **[1]**

(ii)

(a) Calculate the net profit percentage on sales for 2010 and 2011 **[1]**

(b) Has the net profit percentage changed between 2010 and 2011? If so, provide TWO reasons that could cause the net profit percentage to change **[2]**

(c) Briefly explain what the net profit percentage in 2011 means **[1]**

(iii) Calculate the following for the 2011 year

(a) Days inventory on hand **[1]**

(b) Creditors payment period **[1]**

(c) Debtors collection period **[1]**

(iv) What is the length of the businesses working capital cycle for 2011? **[2]**

(v) What do you understand by the following terms

(a) Days inventory on hand **[1]**

(b) Creditors payment period **[1]**

(c) Debtors collection period **[1]**

(vi)

(a) Calculate the total asset turnover for 2010 and 2011 **[1]**

(b) Briefly explain what the total asset turnover represents **[1]**

(vii)

(a) Calculate the current ratio and the acid test ratio for 2010 and 2011 **[1]**

(b) Briefly explain the difference between the current ratio and the acid test ratio **[1]**

(c) What type of companies would use the acid test ratio? **[1]**

(d) What are these ratios attempting to measure? **[1]**

(viii) Briefly explain what you understand by the following terms

(a) Gearing **[1]**

(b) Financial risk **[1]**

(c) Capital structure **[1]**

QUESTION FOUR [25 Marks]

You have almost completed your 2nd year of accounting at NUST and a friend has approached you for some advice. He has given you the following information extracted from the accounting records of his business, Bravo Gifts:

	2011		**2010**	
	Dr	**Cr**	**Dr**	**Cr**
	$'000	**$'000**	**$'000**	**$'000**
Trade creditors		1 750		2 250
Accrued telephone expenses		75		63
Prepaid rent	25		20	
Accrued service revenue	43		56	
Accrued interest expense		4		3
Sundry payables		138		162
Trade debtors	5 500		4 875	
Goodwill	238		250	
Plant, Property and Equipment - PPE (at cost)	1 962		2 000	
Accumulated depreciation: Plant, Property and Equipment		405		380
Ordinary share capital (par value $2)		500		500
Loans (10 % per annum)		150		150
Accumulated profit		4 984.5		3 997
Shareholders for dividends		37.5		20
Bank	276		324	

Bravo Gifts

Income statement for the year ended 30 June 2011.

	$' 000
Sales	20 000
Less: Cost of sales	7 500
Opening inventory	2 500
Add: Purchases	10 000
	12 500
Less: Closing inventory	(5 000)
Gross profit	12 500
Other income	1 500
Service income	1 250
Interest income	250
	14 000
Less: Operating expenses	(12 485)
Profit before tax	1 515
Interest expense (finance costs)	(15)
Profit before tax	1 500
Taxation	(450)
Net profit after tax	1 050

Bravo Gifts

Extract from the Statement of Changes in Equity for the year ended 30 June 2011.

	Accumulated profit $'000
Balance at 30 June 2010	3 997
Net profit after tax	1 050
Dividends	(62.5)
Balance at 30 June 2011	4 984.5

Additional information:

i) The following items are included in operating expenses:

	$'000
Bad debts expense	125
Depreciation expense	?
Profit on sale of assets	?
Goodwill amortised	12

ii) During the year the firm disposed of a vehicle (included in PPE) for $105 000 cash. The vehicle that was sold had a net book value of $75 000 on the date of sale. The business replaced the vehicle with a new vehicle costing $312 000

iii) The directors declared a final dividend of $37 500 on 29 June 2011 payable on 31 July 2011.

iv) The company accountant has made no provisional tax payments for the 2011 financial year, but made a payment of $450 000 *(which was the same as the estimated taxation expense)* on 30 June 2011.

REQUIRED:

(a) Prepare the Cash flow from operations section of the Cash Flow Statement of Bravo Gifts Ltd for the year ended 30 June 2011 insofar as the given information allows using the direct method. **[15]**

(b) Calculate the amount of interest paid during the year ended 30 June 2011 **[2]**

(c) Prepare the note reconciling net profit before interest and tax with cash generated from operations. **[6]**

(d) Calculate the dividend that a shareholder with 500 shares is entitled to for the year ended 30 June 2011. **[2]**

QUESTION FIVE [25 Marks]

The following abridged trial balance was presented for Putuma (Pty) Ltd at 30 June 2011:

	Dr	Cr
	$	**$**
Ordinary share capital		550 000
Revaluation reserve		105 000
Retained earnings		350 000
Land and buildings	850 000	
Investment in subsidiary at cost – **note 1**	200 000	
Inventory	65 000	
Accounts receivable	25 000	
Bank	42 000	
Accounts payable		102 000
Ordinary dividend payable		50 000
Ordinary dividend declared at 29 June 2006	50 000	
Sales		1 224 000
Dividends received		15 000
Cost of sales	935 000	
Operating costs	209 000	
Taxation	20 000	
	2 396 000	2 396 000

<u>Note 1</u>:

Putuma (Pty) Ltd acquired 75% of the equity (and control) of Simphiwe (Pty) Ltd in February 2008. Putuma (Pty) Ltd has no other subsidiaries.

The following analysis of equity has been prepared, which you can assume to be correct on all aspects:

Analysis of Equity of Simphiwe (Pty) Ltd at 30 June 2011

	100%	75%	25%
At acquisition:			
Share capital	140 000	105 000	35 000
Share premium	14 000	10 500	3 500
Revaluation reserve	20 000	15 000	5 000
Retained earnings	45 000	33 750	11 250
Plant	20 000	15 000	5 000
Inventory	8 000	6 000	2 000
	247 000	185 250	61 750
Investment		?	
Goodwill		?	
Since acquisition:			
Revaluation reserve	15 000	11 250	3 750
Retained earnings	60 000	45 000	15 000
Inventory	(8 000)	(6 000)	(2 000)
Plant - depreciation adjustment	(5 000)	(3 750)	(1 250)
Current year:			
Net income after tax	50 000	37 500	12 500
Plant - depreciation adjustment	(5 000)	(3 750)	(1 250)
Dividend	(20 000)	(15 000)	(5 000)
	?	?	?

REQUIRED:
Prepare all the **pro-forma journal entries** required to prepare the consolidated financial statements of Putuma (Pty) Limited and its subsidiary for the year ended 30 June 2011. **[25]**

END OF EXAMINATION PAPER