National University of Science and Technology

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING

SECOND SEMESTER EXAMINATION: 2013

DATE:	**MAY 2013**
SUBJECT:	**FINANCIAL ACCOUNTING 2B: CAC 2201**
TIME ALLOWED:	**THREE (3) HOURS**
MARKS:	**100**

INSTRUCTION TO THE CANDIDATES

1. Answer **all** questions
2. Begin each Full question on a new page

INFORMATION FOR CANDIDATES

1. All workings should be shown
2. All answers should be presented in good style

Question one [25 Marks]

(a) Define the term control in accordance with IFRS 10: *Consolidated Financial Statements* and state instances when control can be achieved. **[7]**

(b) Daj Ltd is company that is involved in the manufacturing of boats that are used in the Zambezi valley for fishing purposes. On 31 December 2012 the company purchased all assets and liabilities of Rauch partnership. Rauch is partnership founded by three partners which is involved in the fishing in the Zambezi valley.

The following are the assets and liabilities of Rauch Partnership as at 31 December 2012

	Carrying amount	**Fair Value**
	$	**$**
Buildings	1,250,000	1,545,000
Delivery Vehicles	180,000	165,000
Furniture and equipment	350,000	330,000
Inventory –Fish	4,700,000	4,850,000
Trade and other receivables	1,650,000	1,650,000
Trade and other payables	920,000	920,000
Bank	475,000	475,000
Loan	1,150,000	1,150,000

Additional information

i. The only reserves and equity that existed at acquisition date were retained earnings.

ii. An amount of $6,750,000 was paid for all the assets and liabilities.

iii. All the entities have a financial year end of 31 December 2012.

Required

(i) Discuss, with reasons, how the transactions will be accounted for in the financial statements of Daj Ltd for the year ended 31 December 2012. **[5]**

(ii) Assume that the above transaction did meet the definition of a business combination in accordance with IFRS 3*: Business Combination*. What steps need to be taken so as calculate the goodwill or a gain from a bargain purchase? Calculate the goodwill or gain from a bargain purchase of the above transaction. **[5]**

(iii) State and explain how the goodwill or gain from a bargain purchase calculated in (b) above will be treated in the financial statements of Daj Ltd. **[3]**

(iv) Discuss with reasons if Pro forma consolidation journal will be required in the consolidated financial statements of Daj Ltd group for the year ended 31 December 2012. **[5]**

Question two [25 Marks]

You are the auditor of Blink Ltd, a listed company based in Zimbabwe. The company's business model is to hold financial assets in order to collect contractual cash flows.

Blink Ltd is currently in the process of finalising their financial statements for the year ended 31 October 2012. Blink Ltd uses IFRS 9: *Financial Instruments* that was issued in October 2010.

Blink Ltd requires your assistance to account for the following transactions:

i. Purchase of shares

On 1 November 2011 Blink Ltd purchased 250,000 Datameg Ltd shares at $25 each. Blink Ltd paid brokerage fees of $93,750 to the brokerage house. Blink Ltd irrevocably elected to present subsequent changes in fair value of the investment in shares in other comprehensive income. The shares were acquired for strategic reasons and not held for speculative purposes. The share price increased to $28 on 31 October 2012. Blink Limited sold 30% of the shares on 31 October 2012 at market value. The costs to sell the shares amounted to $35 000. On 15 October 2012 Blink Ltd purchased 50 000 Suga Ltd shares at $45 each. Blink Ltd paid brokerage fees of $33 750 on the transaction date. The price of these shares decreased to $43 on 31 October 2012.

ii. Government Bonds

Blink Ltd purchased government bonds on 1 March 2012 at a discount of 6% on the face value thereof. The face value of the bonds is $500 000. The bonds bear interest on the face value at 9% per annum, payable in arrears on 1 September and 1 March. The bonds will be redeemed in cash on 28 February 2014 at face value. Transaction costs amounted to $5 000.

iii. Dumbo Ltd

Dumbo Limited issued 100 000 debentures of $1 each on 1 January 2012. The debentures bear interest at 12% per annum payable annually in arrears. The debentures are repayable by the issuance of ordinary shares of $1 each as soon as the prime interest rate reaches 16% per year. If this goal is not reached by 31 December 2016, the debentures will be redeemed in cash. The prime interest rate is 12% at the moment and economists are not sure how the inflation rate will perform in the future.

(a) Provide all the journal entries to correctly account for the shares in Datameg Ltd and Suga Ltd for the year ended 31 October 2012. **[10]**

(b) Provide the journal entries to correctly reflect the government gilts for the year ended 31 October 2012. **[9]**

(c) Discuss whether the debentures should be classified as equity or a liability in terms of the International Financial Reporting Standards (IFRS). **[6]**

Question three [25 Marks]

(a) State and explain situations that individually or in combination will lead a lease to be classified as a finance lease. **[5]**

(b) Briefly explain the qualitative characteristics of financial information contained in the IASB Framework. **[8]**

(c) Hamilton Ltd operates in the pharmaceutical business. The following information relates to the company's activities in research and development for the year ended 31 October 2012.

i. Commercial production started on 1 June 2008 for Formula A. By 31 October 2011 $43,000 had been capitalised in respect of development expenditure on this product. During the year a further $10,000 was spent on development of the product.

Hamilton Ltd has taken out a patent in respect of the formula A which will last for 10 years. Legal and administrative expenses in relation to this were $2,000.

In the current year, sales of Formula A amounted to $50,000. Sales over the next three years are expected to be $150,000, $200,000 and $100,000 respectively.

ii. The development of Formula B is at an earlier stage. Although the company believes it has a reasonable expectation of future benefits from this project it has not as yet been able to demonstrate this sufficient certainty. Expenditure on this project in the current year was $20,000.

Required

(a) Calculate the total amount to be charged to the profit and loss in respect of the above for the year ended 31 October 2012. **[3]**

(b) Draft the table showing the movement on intangible assets which would appear in the notes to the financial statements of Hamilton Ltd for the year ended 31 October 2012. **[9]**

Question Four [25 Marks]

The statements of financial position for ERT and BNM as at 31 December 2012 are provided below:

	ERT	**BNM**
	$'000	**$'000**
Assets		
Non-current assets		
Property, plant and equipment	12,000	4,000
Investment in BNM	4,000	-
	16,000	4,000
Current assets		
Inventories	2,200	800
Receivables	3,400	900
Cash and cash equivalent	800	300
Total assets	**22,400**	**6,000**
Equity and liabilities		
Share Capital ($1 equity shares)	10,000	1,000
Retained earnings	7,500	4,000
Other reserves	200	-
Non-current liabilities		
Long-term liabilities	2,700	-
Current liabilities	2,000	1,000

Total equity and liabilities	**<u>22,400</u>**	**<u>6,000</u>**

Additional information:

i. ERT acquired a 75% investment in BNM on 1 May 2012 for $3,800,000. The investment has been classified as available for sale in the books of ERT. The gain on its subsequent measurement as at 31 December 2012 has been recorded within other reserves in ERT's individual financial statements. At the date of acquisition BNM had retained earnings of $3,200,000.

ii. It is the group policy to value non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interest at 1 May 2012 was $1,600,000.

iii. As at 1 May 2012 the fair value of the net assets acquired was the same as the book value with the following exceptions: The fair value of property, plant and equipment was $800,000 higher than the book value. These assets were assessed to have an estimated useful life of 16 years from the date of acquisition. A full year's depreciation is charged in the year of acquisition and none in the year of sale. The fair value of inventories was estimated to be $200,000 higher than the book value. All of these inventories were sold by 31 December 2012.

On acquisition ERT identified an intangible asset that BNM developed internally but which met the recognition criteria of IAS 38 Intangible Assets. This intangible asset is expected to generate economic benefit from the date of acquisition until 31 December 2013 and was valued at $150,000 at the date of acquisition. A contingent liability, which had a fair value of $210,000 at the date of acquisition, had a fair value of $84,000 at 31 December 2012.

iv. An impairment review was conducted at 31 December 2012 and it was decided that the goodwill on the acquisition of BNM was impaired by 20%.

v. ERT sold goods to BNM for $300,000. Half of these goods remained in inventories at 31 December 2012. ERT makes 20% margin on all sales.

vi. No dividends were paid by either entity in the year ended 31 December 2012.

Required

(a) Explain how the fair value adjustments identified above will impact BOTH the calculation of goodwill on the acquisition of BNM and the consolidated financial statements of the ERT group for the year ended 31 December 2012. **[5]**

(b) Prepare the consolidated statement of financial position as at 31 December 2012 for the ERT Group. **[20]**

END OF EXAMINATION PAPER