National University of Science and Technology

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING

SECOND SEMESTER SUPPLEMENTARYEXAMINATION: 2013

DATE:	**SEPTEMBER 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]

On 1 January 2012, when the market interest rates were 12%, Federer Ltd purchased the following securities:

1 000 10%debentures in Nadal Ltd with a par value of $1 each that will mature on 31 December 2022. The interest is payable annually on 31 December. Federer Ltd intends to manage the debentures in Nadal Ltd within a business model with the objective to collect contractual cash flows and to hold the investment until maturity.

Fair value **$887 ***

5 000 14% debentures in Djokovic with a par value of $1 each. Interest is payable annually on 31 December and will mature on 31 December 2016 at par.

Fair value **$5 360 ***

100 ordinary shares in Sampras Ltd. Federer anticipate that the price of the shares will rise by 10% at which point the shares will be sold.

Fair value **$2 200 ***

150 ordinary shares in Agassi Ltd. Federer Ltd has no immediate plans to sell the shares. Fair value **$5 600 ***

***** including transaction costs of $100 per investment.

Additional information

- **i.** At the end of 2012, the fair values of investments in Sampras Ltd and Agassi Ltd were $2 700 and $5 190 respectively.
- **ii.** Interest rates have fallen at 31 December to 10%
- **iii.** Assume financial year end is 31 December

Required

(a) Discuss the initial recognition and the initial and subsequent measurement of the above mentioned financial instruments. **[10]**

(b) Prepare journal entries for the year ended 31 December 2012, for the above mentioned transactions in the books of Federer **[15]**

Question two [25 Marks]

(a) MX acquired 80% of the 1 million issued $1 ordinary share capital of FZ on 1 May 2012 for $1,750,000 when FZ's retained earnings were $920,000.

The carrying value was considered to be the same as fair value with the exception of the following:

The carrying value of FZ's property, plant and equipment at 1 May 2012 was $680,000.

The market value at that date was estimated at $745,000. The remaining useful life of the property, plant and equipment was estimated at 5 years from the date of acquisition.

FZ had a contingent liability with a fair value of $100,000. There was no change to the value of this liability at the year-end.

MX estimates that the costs of reorganising the combined entity following acquisition will be $200,000.

MX depreciates all assets on a straight line basis over their estimated useful lives on a monthly basis.

FZ sold goods to MX with a sales value of $300,000 during the 8 months since the acquisition. All of these goods remain in MX's inventories at the year end. FZ makes 20% gross profit margin on all sales.

The retained earnings reported in the financial statements of MX and FZ as at 31 December 2012 are $3.2 million and $1.1 million respectively. There has been no impairment to goodwill since the date of acquisition.

The group policy is to measure non-controlling interest at fair value at the date of acquisition. The fair value of non-controlling interest at 1 May 2012 was $320,000.

Required:

Calculate the amounts that will appear in the consolidated statement of financial position of the MX Group as at 31 December 2012 for:

(i) Goodwill; **[4]**

(ii) Consolidated retained earnings; and **[3]**

(iii) Non-controlling interest. **[3]**

(b) Explain why consolidated financial statements are useful to the users of financial statements (as opposed to just the parent company's separate (entity) financial statements). **[5]**

(c) Describe the circumstances in which gain on bargain purchase may arise. **[5]**

(d) A financial assistant has observed that the fair value exercise means that a subsidiary's net assets are included at acquisition at their fair (current) values in the consolidated statement of financial position. The assistant believes that it is inconsistent to aggregate the subsidiary's net assets with those of the parent because most of the parent's assets are carried at historical cost.

Required:

Comment on the assistant's observation and explain why the net assets of acquired subsidiaries are consolidated at acquisition at their fair values. **[5]**

Question three [25 Marks]

Highlanders Ltd acquired its 80% interest in the ordinary shares and 25 % interest in the redeemable preference shares of Dynamos Ltd for $9,000 and $1,000 respectively on 1 April 2006 when Dynamos Ltd's retained earnings were $4,000. There were no other reserves at that date. The preference shares carry no votes.

The following are draft income statements of Highlanders Ltd and Dynamos Ltd for the year ended 31 March 2012

	Highlanders Ltd	**Dynamos Ltd**
	$	**$**
Revenue	274,500	181,250
Cost of sales	126,480	86,520
Gross profit	148,020	94,730
Dividends from Dynamos Ltd		
Ordinary	4,800	-
Preference	150	-
Interest received	250	100
	153,220	94,830

Distribution costs	67,315	42,885
Administrative costs	25,555	17,295
Preference dividend	-	600
Profit before tax	60,350	34,050
Income tax expense	29,000	15,100
Profit for the period	**31,350**	**18,950**

The following information is also available:

1. The inventory of Highlanders Ltd at 31 March 2012 includes goods purchased from Dynamos Ltd at a profit to that company of $700. Total intra company group sales for the year amounted to $37,500.

2. On 1 April 2011 Highlanders Ltd sold plant costing $7,000 to Dynamos Ltd for $10,000. The profit on sale has been taken to cost of sales. Depreciation has been provided by Dynamos Ltd at 10% per annum on the cost of $10,000.

3. Included in Dynamos Ltd‘s administrative costs is an amount for $3,500 in respect of management charges invoiced and included in revenue by Highlanders Ltd.

4. Dynamos Ltd’s issued share capital comprises 10,000 50c ordinary shares and 4,000 $115% redeemable preference shares.

5. four years ago a goodwill impairment loss was recognised in Highlanders Ltd consolidated financial statements leaving goodwill in the consolidated statement of financial position at $1,200. A further $180 impairment loss needs to be recognised in the current year.

6. Retained earnings at 1 April 2011 were $576,000 for Highlanders Ltd and $72,600 for Dynamos Ltd.

Required

(a) Prepare the consolidated statement of profit or loss account and other comprehensive income for the year ended 31 March 2012 and calculate the retained earnings brought forward attributable to the owners of Highlanders Ltd and non controlling interest. **[13]**

(b) For each adjustment you have made above, prepare relevant journal entries.**[12]**

Question four [25 Marks]

AF IS A Furniture manufacturing entity. The trial balance for AF at 31 March 2013 was as follows:

	Dr	Cr
	$,000	$,000
6% loan notes (redeemable 2017)		1,500
Accumulated profits at 31/03/2012		388
Administrative expenses	1,540	
Available for sale investment at market value 31/03/2012	1,640	
Bank and cash	822	
Cost of sales	3,463	
Distribution costs	1,590	
Dividend paid 01/12/2012	275	
Interest paid on loan notes half year to 30/09/2012	45	
Inventory at 31/03/2013	1,320	
investment income received		68
Land and buildings at cost	5,190	
Ordinary share of $1 each fully paid		4,500
Plant and Equipment at cost	3,400	
Provision for deferred tax		710
Provision for depreciation 31/03/2012: Buildings		1,500
Provision for depreciation 31/03/2012: Plant and Equipment		1,659
Revaluation Reserve		330
Sales Revenue		8,210
Share Premium		1,380
Trade payables		520
Trade receivables	1,480	
	20,765	20,765

Additional information

(i) Available for sale investment are carried in the financial statements at market value. The market value of the available for sale investment at 31 March 2013 was $1,750,000.

(ii) There were no sales or purchases of non-current assets or available for sale investment during the year ended 31 March 2013.

(iii) Income tax due for the year ended 31 March 2013 is estimated at $250,000. There is no balance outstanding in relation to the previous year's income tax. The deferred tax provision needs to be increased by $100,000.

(iv) Depreciation is charged on buildings using a straight line basis at 3% each year. The cost of land included in land and buildings is $2,00,000. Plant and equipment is depreciated using the reducing balance method at 20%. It is regarded as cost of sales.

(v) AF entered into a non-cancellable five year lease on 01 April 2012 to acquire machinery to manufacture a new range of kitchen units. Under the terms of the lease, AF will receive the first year rent free, then $62,500 is payable for four years commencing in year two of the lease. The machine is estimated to have a useful economic life of 20 years.

(vi) The 6% loans are 10 year loans due for payment in March 2015. AF incurred no other finance cots in the year to 31 March 13, 2013.

Required

Prepare the Statement of Comprehensive Income for the year to 31 March 2013 and the Statement of Financial Position at that date, in a form suitable for presentation to the shareholders and in accordance with the requirements of International Financial Reporting Standards. (IFRS). **[25]**

NB notes to the financial statements are not required

END OF EXAMINATION PAPER