National University of Science and Technology

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING

FIRST SEMESTER EXAMINATION: 2013

DATE:	**DECEMBER 2013**
SUBJECT:	**FINANCIAL REPORTING: CAC 4101**
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]

Nust Ltd is a company listed in the Retail Sector of the Zimbabwe Stock Exchange (ZSE). Nust Ltd has many departmental stores and is one of the top performers in this segment of the market.

You have been approached to assist in preliminary negotiations for the sale of a 70% equity interest in Nust Ltd to UZ Ltd. The shares are currently held by the directors of Nust Ltd and you have been provided with extracts of the latest statement of financial position and statement of comprehensive income for the year just ended as well as a financial forecast for the next three years.

You have recently completed a financial analysis of Nust Ltd in comparison to returns of similar companies quoted on the ZSE and you have ascertained the following:

Covariance of returns between Nust Ltd and the market	+0.0294
Standard deviation of returns for Nust Ltd	0.18
Standard deviation of returns for the market	0.14
Market returns	18%
Risk free rate	9%

Current and forecast statements of financial position for Nust Ltd as at 30 April, obtained from the management accounts

	2013	**2014**	**2015**	**2016**
	$000	**$000**	**$000**	**$000**
Capital employed				
Issued share capital	1000	1000	1000	1000
Non distributable reserve	2000	2000	2000	2000
Distributable reserve	2200	3000	4000	4500
Preference shares	2000	2000	2000	2000
Debentures	3000	3000	3000	3000
Deferred tax	340	620	410	380
	10540	**11620**	**12410**	**12880**
Employment of capital				
Non-current assets	7960	8670	8820	10180
Investments	2000	2000	2000	2000
Inventory and receivables	2000	2500	3200	2800
Accounts payables	(600)	(900)	(700)	(1200)
Zimra	(320)	(450)	(610)	(500)

Short term borrowings	(500)	(200)	(300)	(400)
	10540	**11620**	**12410**	**12880**

Statements of comprehensive income of Nust Ltd for the years ending 30 April

	2013	**2014**	**2015**	**2016**
	$000	**$000**	**$000**	**$000**
Gross profit	7940	10742	14296	8661
Depreciation	(500)	(750)	(900)	(1100)
Expenses	(5580)	(6120)	(8628)	(4400)
Profit before tax	1860	3872	4768	3161
Debenture interest	(780)	(780)	(780)	(780)
Other interest	(120)	(48)	(72)	(96)
Profit before taxation	960	3044	3916	2285
Income tax expense	(320)	(740)	(950)	(560)
Profit after tax	640	2304	2966	1725
Dividend income	600	636	674	715
Preference share dividend	(340)	(340)	(340)	(340)
Ordinary share dividend	(400)	(1800)	(2300)	(1600)
Retained income	**500**	**800**	**1000**	**500**

You may assume the following for the purposes of your valuation of Nust Ltd:

Corporate income tax rate	28%
Target debt: equity ratio	2:3
Cash flows are expected to grow at 14% from 2016 onwards	
Target debt structure is 50% preference shares: 50% debentures	
Current debenture rate	15%
Current preference share return	12%
Short-term overdraft rate (prime plus)	16%

Required

Determine the value of Nust Ltd using the free cash flow method. Show your workings and any assumptions you make in your answer. **[25]**

Formula $\beta = \frac{\text{covariance}}{\sigma^2}$

Question two [25 Marks]

You are the financial accountant Lsu Ltd, a manufacturing company situated at Belmont industrial site. Lsu Ltd specialises in the manufacturing of Maputi. The company has a 31 December year-end. The following is an extract concerning their assets.

Land and Buildings

Land and Buildings were bought on 1 January 2011 at a cost of $1,250,000 (Land: $500,000; manufacturing building $750,000). At that stage 5% of the building was used by Lsu Ltd in the manufacturing process. The portion of the building of 5% is regarded as insignificant. The remaining space is rented out. Due to demand for Maputi, Lsu Ltd expanded their production facilities and as a result did not renew the rental agreement that expired on 1 January 2012, but occupied the whole manufacturing for their own manufacturing activities.

The following were the fair values (net replacement values) on the different dates indicated.

	Land	**Buildings**
	$	**$**
31/12/2011 Fair value	510,000	753,000
01/01/2012 Fair value	510,000	753,000
31/12/2012 Fair Value	520,000	770,000
01/01/2011 useful life	-	30 years

Machine

On 30 June 2011 Lsu Ltd bought a new machine with useful life of ten (10) years and no residual value. The machine must undergo major inspection every 2,000 working hours, therefore approximately once a year. The estimated cost of a major inspection is $15,000. Due to increases in production of Maputi, the inspection was done on 1 January 2012 at a cost of $20,000. The machine was idle for a period of one month during the servicing of the machine.

30/06/2011	original cost of machine	$150,000

Additional information

i. The following are the accounting policies of Lsu Ltd concerning assets:

- Land and building are carried under IAS 16 *Property, Plant and Equipment* at revalued amount according to the net replacement values;
- Machinery is carried at cost less accumulated depreciation and impairment losses;
- Revaluation surplus are realised when the underlying asset are sold;
- Investment property is carried at fair value.

ii. The Zimbabwe Revenue Authority allows the following as deductions against income;

- A 5% building allowance per annum on industrial buildings, not proportioned for part of the year.
- A 40/20/20/20% wear and tear per annum on machinery, not proportioned for the year
- The inspection fees, 100 % deduction in the year that it is paid.

iii. The applicable tax rate is 30%

iv. Deferred tax is provided on all temporary differences by using the Statement of Financial Position, method.

v The revaluations were done by Miss Moyo an independent sworn appraiser. Miss Moyo holds a recognised and relevant professional qualification and has recent experience in the location and category of the property being valued. The fair values were determined by reference to current market evidence and the latest valuation took place on 31 December 2012.

Required

Disclose the above information in the following notes to the annual financial Statements of Lsu Ltd for the year ended 31 December 2012. Your answer should comply with the requirements of International Financial Reporting Standards (IFRS):

- Property, Plant and Equipment **[15]**
- Investment Property **[5]**
- Deferred tax **[5]**

Question three [25 Marks]

C Ltd had the following transactions in the year ended 30 June 2013.

i. A computer controlled cutting machine was leased at a cost of $40,000 per annum payable in advance. The primary lease term is for five years from 1 July 2012 and the machine is expected to have a useful life of five years, with no residual value. The machine would have cost $175,000 if bought outright. C Ltd is responsible for the maintenance and insurance of the asset. The interest rate implicit in the agreement is 8% per annum and the present value of the minimum lease payment is $172,480.

ii. Items of office equipment were leased at a cost of $7,500 per month payable in advance. The lease term is for two years from 1 September 2012 and can be cancelled at any time by either party to the lease. Any maintenance is carried out by the lessor. The office equipment would have cost $300,000 if bought outright and it expected to have a useful life of six years.

iii. An agreement was entered into on 1 July 2012 for the lease of a robotic machine at an annual cost of $30,000 payable in arrears on 30 June each year. The agreement is for five years and C Ltd has the option to purchase the asset at the end of the five years at a nominal cost. The asset is expected to have a useful life of eight years. The machine would cost $120,000 if bought outright. The interest implicit in the agreement is 8% per annum and the present value of the minimum lease payment is $119,790.

iv. A long-term lease of 40 years for land and buildings with lease payments of $60,000 per annum in advance was entered into on 1 July 2012. The fair value of the leasehold interest has been estimated at $600,000 of which $60,000 relates to land and $540,000 to buildings.

The useful life of the buildings has been professionally assessed at 45 years. The interest rate implicit in the lease is 10% and the present value of minimum lease payments attributable to the buildings is $528,120.

Required

(a) Briefly explain how a finance lease can be classified. [**5]**

(b) Prepare the extract of the Statement of Profit and Loss and other Comprehensive Income and the Statement of Financial Position and Notes to the financial Statements for the year ended 30 June 2013. You should use the actuarial method to apportion any finance charges. **[20]**

Question four [25 Marks]

(a)Describe the following

(i) Purpose of a Value Added Statement **[5]**

(ii) Meaning of authorization in accordance with IAS 10 *Events after the reporting period* **[5]**

(iii) Recognition criteria for the sale of goods in accordance with IAS 18 *Revenue* **. [5]**

(b) Critically discuss the definition of assets and liabilities contained in the Framework. Your answer should explain the importance of the definitions and the relevance of each component of the definitions. [**10]**

END OF EXAMINATION PAPER