National University of Science and Technology

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING

FIRST SEMESTER SUPPLEMENTARY EXAMINATION: 2014

DATE: JULY 2014

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]

The following is the trial balance H Ltd at 30 June 201 3

	$	$
Revenue		390,000
Cost of sales	210,600	
Distribution costs	6,800	
Administration costs	12,700	
Loan interest paid	3,600	
Property –Cost	150,000	
Property –depreciation at 1 July 2012		38,400
Plant and equipment at cost	176,200	
Plant and equipment depreciation at 1 July 12		48,600
Trade receivables	31,600	
Inventory -30 June 2013-09-23	18,100	
Bank	1,950	
Trade payables		25,400
Ordinary shares $1		50,000
Share premium		9,000
12% loan note (issued 1 July 2012)		40,000
Taxation	1,300	
Retained earnings at 1 July 2012		11,450
	612,850	**612,850**

The following information is relevant:

1. Property includes land at a cost of $30,000. The building is being depreciated on a straight line basis over its estimated useful life of 25 years.

2. Plant and equipment is being depreciated on the reducing balance basis at a rate of 20% per annum

3. The balance on plant and equipment included a piece of specialist machinery that cost $70,000 on I July 2011. On 30 June 2013 a fork-lift reversed into the machinery causing severe damage. H Ltd has identified possible options:

(i) Sell the machine

A potential buyer has been located, who has indicated that she would pay 80% of the carrying amount at 30 June 2013.

However she has insisted that the machine is repaired before she buys it. The repair work will be done by H Ltd’s employees and will take about 120 hours of skilled labour; the associated cost with this labour is $2,160. In addition H Ltd will have to deliver the machine to the buyer at a cost of $2,100 and there will be a single premium insurance cost of $580 for the journey

(ii) Repair the machine and continue using it

The financial controller has estimated that the present value of cash flows generated from future use (including repair cost) amount to $31,800.

4. All depreciation is charged to cost of sales.

5. The directors have estimated the provision for income tax for the year ended 30 June 2013 at $6,500

Required

Prepare the Statement of Profit and Loss for H Ltd for the year ended 30 June 2013 and a Statement of Financial Position at that date and the Notes to the financial statements.

Accounting policy notes required.

Question two [25 Marks]

Describe the following terms

(a) Asset in accordance with the Framework [5]

(b) Recoverable amount in terms of IAS 36 *Impairment of assets.* [5]

(c) Adjusting and non adjusting items in accordance with IAS 10 *Events after the reporting period.* [5]

(d) Impairment loss [5]

(e) Outline the disclosure requirements of revenue [5]

Question three [25 Marks]

Miss K received a significant inheritance from her grandparent a number of years ago and as a result founded her own label cosmetics business, KL. Miss K’s friend is a renowned actress and agreed; at the time the business was founded, to become the “face” of the brand in return for 5% of KL’s equity. She has since been seen in all of the entity’s advertising which has successfully resulted in KL rapidly gaining market share. KL now sells a large range of cosmetic products, typically to large department stores.

However, despite the rapid gain in market share leading to increased revenues, KL was loss making for the first few years of operation due to the significant costs involved in developing the large range of products and the brand. KL has also struggled to manage working capital as the large department stores require inventories to be available to them immediately and have demanded extended credit terms.

KL issued a convertible loan instrument in 2010 to Mr. B, a private investor, and invested the funds in further developing brand awareness in advance of launching the brand in the Asia markets at the start of November 2012.

The convertible loan instrument is due for repayment or conversion in December 2013. Mr. B is in the fortunate position of not requiring the repayment and is considering converting the instrument into equity. He would, therefore, like an assessment of whether or not KL is likely to be a successful equity investment.

The financial statements for KL are provided below:

	2012	2011
	$'000	**$'000**
Assets		
Non-current assets		
Property, Plant and equipment	1,665	1,626
Current assets		
Inventories	750	800
Trade and other receivables	45	60
Total assets	**2,460**	**2,486**
Equity and liabilities		
Share capital	1,500	1,500
Other elements of equity	10	10
Retained earnings	40	(210)
Non-current liabilities		
5% convertible debt 2013	360	336
Current liabilities		
Trade and other payables	550	850
Total and equity and liabilities	**2,460**	**2486**

Statement of profit or Loss and Other Comprehensive income for the year ended 31 December 2012

	2012	**2011**
	$'000	**$'000**
Revenue	2,600	2,300
Cost of Sales	(1,800)	(1,700)
Gross profit	800	600
Distribution costs	(310)	(210)
Administrative expenses	(114)	(137)
Finance costs	(24)	(20)
Profit before tax	352	233
Income tax expense	(102)	(68)
Profit for the period	**250**	**165**

Required:

(a) A report that analyses the financial performance and the financial position of KL based on all the information provided (8 marks are available for the calculation of relevant ratios. [20]

(b) Explain any limitations of doing a trend analysis [5]

<u>Question four [25 Marks]</u>

Orange Ltd prepares its financial statements to 30 September each year. On 1 October 2012 Orange had ten million 50c shares in issue and on 1 April 2013 made a 1 for 5 rights issue at a price of $1.20 per share. The market price of Lemon share immediately before the rights issue was announced was $1.50. Earnings for the year ended 30 September 2013 were $4,697,000.

At 30 September 2013, details of the stock options granted by the company to its employees in the previous years are as follows:

Number of share options granted and outstanding	**Exercise price $**
10,000,000	7.00
500,000	9.00
200,000	8.00
900,000	12.00
500,00	10.50

The average price of the company's shares was $10 for the year ended 30 September 2013

Orange Ltd also has in issue $3,200,000 of 6% convertible redeemable loan stock with the following terms of conversion for every $100 of loan stock:

Conversion at 30 September 2014 108 shares

Conversion at 30 September 2015 104 shares

The liability component of the convertible redeemable loan stock was carried in the Statement of Financial position on 1 October 2012 at $3 million and the effective interest rate is 9%

Lemon pays a tax at a rate of 30%

Required

(a) Calculate basic and diluted earnings per share for the year ended 30 September 2013. **[12]**

(b) Explain to a holder of Orange Ltd share both usefulness and limitations of the basic and the diluted earnings per share figures**.** **[8]**

(c) **I**dentify all the potential ordinary shares for 2013 EPS calculation and demonstrate whether they are dilutive or anti-dilutive. **[5]**

END OF EXAMINATION PAPER