National University of Science and Technology

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING

SECOND SEMESTER EXAMINATION: 2014

DATE: MAY 2014

SUBJECT: ADVANCED FINANCIAL ACCOUNTING: CAC 5201

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 financial controller of Don Ltd has prepared Don Ltd's own draft Statement of Profit or Loss for the year ended 31 March 2014 and its own Statement of Financial Position as at that date. She has asked you, as Assistant Accountant, to prepare a Statement of changes in equity for Don Ltd before you and she start the consolidation process. Notes (1) to (4) below are relevant to this task

(1)Don Ltd's draft Statement of Profit or Loss for the year ended 31 March 2014 showed a profit for the year of $526,700. Its retained earnings at 1 April 2013 were $2,365,500

(2) During the year the company revalued a particular class of plant and machinery to a total of $650,000. At the date of the revaluation, the plant had a cost of $456,000 and accumulated depreciation of $215,500. Depreciation on the revalued amount of $67,800 was subsequently charged. If depreciation had been charged on cost the charge would have been $45,600. Don Ltd wishes to make annual transfer between the revaluation surplus and retained earnings in accordance with best practice.

(3) Don Ltd had 1 million 5% redeemable $1 preference shares in issue at 31 March 2013 and 2014, which were issued and are redeemable at par. The dividend on these shares was paid on the last day of the year and is not reflected in the profit for the year.

(4) On 31 March 2013 Don Ltd had 2 million 50c ordinary shares in issue, also issued at par. On 16 January 2014 the company issued a further 500,000 50c ordinary shares, at a price of $1,10 per share

Following the preparation of Don Ltd's Statement of changes in equity you have been asked to calculate certain draft profit figures that will appear in Don Ltd's Consolidated Statement of Profit or Loss for the year ended 31 March 2014. Notes (5) and (6) below are relevant

(5) Don Ltd has one subsidiary, Red Ltd, which was acquired on 1 October 2013, and an associated company Cat Ltd, which has been held for a number of years the following information is relevant.

	Red Ltd	Cat Ltd
Holding of ordinary shares by Don Ltd	75%	45%
Profit for the year ended 31 March 2014	$457,000	$103,400
Impairment in goodwill /investment in the year Ended 31 March 2014	$50,000	$10,000

All profits are accrued evenly over the year.

(6) On 1 October 2013 Red Ltd sold an item of plant to Don Ltd. The plant had cost Red Ltd $30,000 on 1 October 2012, which was estimated at five years, was sold to Don Ltd for $40,000. The estimated total useful life of the plant remained unchanged.

Required:

Prepare Don's Ltd's own Statement of Changes in Equity for the year ended 31 March 2014. The total column is not required. **[4]**

Calculate the following figures as they would appear in Don's Ltd's Consolidated Statement of Profit or Loss for the year ended 31 March 2014

(i) Profit attributable to the owners of Don Ltd **[3]**

(ii) Profit attributable to the non-controlling interest **[3]**

(b) Beech Ltd is a manufacturing company. During the year ended 31 March 2014 it acquired shares in two companies Willow Ltd and Laburnum. The information relating to the acquisition is set out below:

	Willow Ltd	Laburnum Ltd
Percentage of ordinary shares acquired	80%	30%
Date of acquisition	1 April 2013	1 October 2013
Issued $1 ordinary shares	100,000	200,000
Excess of fair value of land over carrying amt	$50,000	$25,000
Cost of acquisition	$750,000	$85,000

Summary of the Statement of Profit or Loss for the year ended 31 March 2014 for Beech Ltd and Willow Ltd and Laburnum Ltd are set out below:

	Beech	**Willow**	**Laburnum**
	$	$	$
Revenue	2,450,000	1,526,700	876,800
Cost of sales	(1,345,700)	(917,700)	(679,400)
Gross profit	1,104,300	609,000	197,400
Operating expenses	(877,450)	(467,800)	(97,200)
Profit before tax	226,850	141,200	100,200
Income tax expense	(68,000)	(42,500)	(30,400)
Profit for the period	158,850	98,700	69,800

Additional information

- All revenue and costs accrued evenly over the year.
- All land held at the dates of acquisition was still held on 31 March 2014
- In January 2013 Beech Ltd purchased goods for $9,000 from Willow Ltd and for $5,000 from Laburnum Ltd. All goods sold among the three companies are sold at a gross profit margin of 20%. Half of each set of goods remained in inventory at year end.
- Retained earnings on 31 March 2014 were: Beech Ltd $1,420,500; Willow Ltd $567,400 and Laburnum Ltd $345,700. None of the companies has any reserves other than retained earnings.

Required:

Calculate the following figures for Beech Ltd's Consolidated Financial Statements for the year ended 31 March 2014

(i) Cost of sales

(ii) Share of profits of associate

(iii) Goodwill

(iv) Investment in associate

(v) Retained earnings

(vi) Non-controlling interest **[15]**

Question two [25 Marks]

(a) The financial manager of Lion Ltd wishes to take out a forward contract to hedge a future purchase share which is highly probable. He is uncertain about how the transaction should be treated for accounting purposes and approaches you for advice.

Required:

Discuss how such a hedge should be treated for accounting purposes. **[10]**

(b) Jaguar Ltd is a company incorporated in Zimbabwe. It is involved in the manufacture of an Anti-retroviral drug that is used to boost the immune system of people who are infected with the Acquired Immune Deficiency Syndrome. One of its managers attended a conference in the United Kingdom, and during the conference he met Mr. Cabaye who is the managing director of a company that manufactures machines that produce this drug. Mr. Cabaye informed him of the new machine that will manufacture the drug in the shortest possible time. Mr. Moyo the manager of Jaguar became interested of the machine such that he went on to the company board to tell them of the good news. The board agreed at a meeting on 1 January 2013 to purchase the machine.

On 1 May 2013 the machine was ordered from France in terms of non-cancellable order and the machine was delivered to Jaguar Ltd on 1 July 2013 at a cost of €4 million. The amount owing to the supplier was settled in cash on 10 July 2013. Jaguar Ltd installed and tested the machine during 1 July 2013 and 31 July 2013 (the date the machine was ready for use) at a cost of $200,000. Production using the machine commenced on 1 September 2013.

On 1 May 2013, Jaguar Ltd entered into a Forward Exchange Contract (FEC) to purchase €4 million for delivery on 10 July 2013. Jaguar Ltd designated this FEC as a cash flow hedge of the changes in the spot exchange rate for the period 1 May 2013 to 30 June 2013. For the period 1 July 2013 to 10 July 2013, Jaguar Ltd designated the

FEC as a fair value hedge of the forward exchange rate in the creditor. The hedge **met** all the criteria of IAS 39 *financial instruments: recognition and measurement,* par .88

The fair value of the FEC was as follows:

Date	fair value
	Asset/Liability
1 May 2103	-
1 July 2013	(518,272)
10 July 2013	(280,000)

The following exchange rates are applied:

Date	**spot rate**	**forward exchange to 10 July 2013**
	1€=$	1€=$
1 May 2013	8.55	8.65
1 July 2013	8.50	8.52
10 July 2013	8.58	N/A
31 December 2013	8.80	N/A

The machine is depreciated on a straight line basis over ten years

All items of machinery are assumed to have a residual value of nil unless otherwise indicated.

There was no impairment of assets

Required

Prepare journal entries to record the purchase of the machine from France and to record the Foreign Exchange Contract (FEC) from the date of inception to the date of settlement by applying the appropriate hedge accounting principles **[15]**

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

Super Cat Ltd is company that is listed on the Zimbabwe Stock Exchange. The company operates three segments, namely, eco-tourism, manufacturing and transportation. In addition to its own activities, the company holds investments in local and foreign subsidiaries. The financial reporting framework that Super Cat Ltd group uses is International Financial Reporting Standards (IFRS). The group adopted IFRS 3 (revised 2008), *Business Combinations* and IAS 27 *Separate Financial Statements*, IFRS 10, *Consolidated Financial Statements*, in its separate and consolidated financial statements for the year ended 31December 2013. All companies in the group have a 31 December reporting date. Investments in subsidiaries are measured at cost in the separate financial statements of Super Cat Ltd.

Cheetah Ltd

Super Cat Ltd purchased an 80% controlling interest in Cheetah Ltd on 1 March 2013 for $430,000 (paid in cash on that date). Super Cat elected to measure non-controlling interest at fair value of $128,000. The registered auditors of Cheetah performed no external audit for the period ended 31 March 2013.

The following table shows the carrying amount of equity of Cheetah Ltd on various dates

	1 March 2013	**31 December 2013**
Share capital	100,000	100,000
Retained earnings	250,000	380,000
Revaluation surplus buildings	<u>180,000</u>	<u>300,000</u>

	530,000	780,000

Cheetah revalued its buildings on 1 January 2013. An additional revaluation was performed on 31 December 2013 to ensure that the carrying amount did not differ materially from the fair value at the reporting date. Cheetah does not transfer revaluation surpluses to retained earnings in its individual statements. Depreciation for the year is not based on the most recent revaluation.

Cheetah did not declare any dividends for the year ended 31 December 2013.

Adjustments resulting from the following information are not reflected in the equity of Cheetah:

- The fair value of the buildings of Cheetah was $800,000 on 1 March 2013, which was $40,000 higher than its carrying amount at that date. The buildings have no residual value. On 1 March 2013 the remaining useful life of the buildings was 20 years.
- Cheetah leases certain equipment from a farmer in terms of a finance lease. At that date there were 18 months remaining on the lease agreement. The fair value of the equipment on 1 March 2013 was $230,000. The carrying amount of this equipment was $170,000 on 1 March 2008. The remaining useful life for the farmer was four years
- No other adjustments are required at the date of acquisition.

Super Cat Ltd purchases certain inventory from Cheetah in terms of an agreement which was concluded on January 2011. The contract expires on 30 June 2014. Currently, the price of the inventory in terms of the agreement is lower than the market price at which Super Cat could purchase the inventory from another supplier. The fair value of the contract on 1 March 2013 was $180,000, which includes an off market component of $25,000.

Assume that the tax rate is 28% and capital gains is 14%

Required:

(a) Calculate the goodwill or gain from a bargain purchase arising on the acquisition of Cheetah on 1 March 2013. **[10]**

(b) List the audit procedures that you would perform to audit the accuracy and valuation of the amounts recognized in respect of the acquisition of Cheetah Ltd in the consolidated annual financial statements of the Super Cat group at the date of acquisition. **[10]**

(c) Super Cat acquired another entity, Zebra Ltd, on 1 May 2012. At the time of the acquisition, Zebra was being sued as there is an alleged mis-selling case potentially implicating the entity. The claimants are suing for damages of $10 million. Super Cat estimates that the fair value of any contingent liability is $4 million and feels that it is more likely than not that no outflow of funds will occur.
Super Cat wishes to know how to account for this potential liability in Zebra's entity financial statements and whether the treatment would be the same in the consolidated financial statements.

Required:

Discuss, with suitable computations, the advice that should be given to Super Cat in accounting for the above event. **[5]**

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

Buffalo Ltdis a company that is listed on the Zimbabwe Stock Exchange. It also invests in other companies so as to diversify its risks. The consolidated annual financial statements being in the process of being finalised, but some outstanding issues still need to be resolved

The following selected information is made available

- The group uses the costs model to account for all items of Property, plant and equipment.
- The non-controlling interest has been measured at fair value on the date of acquisition and date of business combination.

- The following international Financial Reporting Standards are applicable
- IFRS 9 financial instruments
- IFRS 10 Consolidated Financial Statements
- IFRS 11 Joint Arrangements
- IFRS 12 Disclosure of Interests in other Entities
- IFRS 13 Fair value Measurement
- IAS 27 Separate Financial Statements
- IAS 28 Investments in Associates and Joint Ventures

Rhino Ltd

Rhino Ltd is a diversified fashion retail group listed on the Zimbabwe Stock Exchange ZSE. Its operating and financial policies are determined by the company's board of directors. All directors of Rhino Ltd are appointed by the shareholders at annual general meetings by simple majority vote. The company had 2,500,000 ordinary shares in issue throughout the period 1 January 2009 to 31 December 2013. Each ordinary share in Rhino Ltd entitles the holder to one vote at shareholders' meetings.

Details of the voting rights represented at the annual general meeting of Rhino's shareholders are as follows:

	Annual general meeting held on				
	30/03/2013	**31/03/2012**	**31/03/2011**	**31/03/2010**	**31/03/2009**
Voting rights Represented, in Proxy	91%	91%	90%	89%	90%

The next annual general meeting of Rhino will be held on 31 March 2014

On 1 March 2009 Buffalo Ltd Acquired 40% of ordinary shares of Rhino Ltd for $45 million.

The following pertains to this acquisition.

- No transaction costs were incurred.

- The net assets recognized by Rhino Ltd were considered to be fairly valued. No additional assets, liabilities or contingent liabilities were identified by Buffalo Ltd on this date.
- Elephant Ltd, an unrelated Zimbabwean company listed on the ZSE , held 10 % of the ordinary shares of Rhino Ltd. The remaining ordinary shares were widely held by shareholders holding less than 1% each of the ordinary share capital.
- Buffalo Ltd correctly classified the interest as an investment in associate.

On 31 December 2013 Buffalo Ltd acquired a further 8% of Rhino Ltd ordinary shares in the open market. The following pertains to this acquisition:

- Buffalo Ltd incurred directly attributable transaction costs of $750,000
- The net assets recognized by Rhino Ltd were considered to be fairly valued except for its production machinery, which was considered to be undervalued by $10 million. No additional assets, liabilities or contingent liabilities were identified by Buffalo Ltd on this date.
- Rhino Ltd ordinary shares were trading at $82.50 per share on the ZSE on 31 December 2013 and the 52% of Rhino Ltd had a fair value equal to the market value.

Details relating to the shareholders' equity of the Rhino group are as follows:

	31/12/2013	01/01/2009
Ordinary share capital	50,000	50,000
Equity –convertible non-cumulative preference		
Shares	15,000	-
Retained earnings	126,500	56,500
Foreign currency translation reserve	(16,000)	(6,000)
Mark to market reserve	6,000	2,000

The unlisted preference shares referred to above were issued on 1 August 2009 and mandatorily convertible into 500,000 shares on 31 July 2014. The shares are not convertible prior to that date. The holders of the preference shares do not have voting rights except on matters that directly affect their rights. The preference shares had a fair value of $16 million on 31 December 2013. The preference shares have been held by Elephant Ltd since August 2009

Hippo Ltd

Buffalo acquired 10% of Hippo Ltd on 1 September 2010 for R1 million. The company is incorporated in South Africa. On the same day Buffalo Ltd acquired an option to purchase an additional 30% of the company at any time between 1 September 2012 and 1 September 2018 at a strike price of R3 million. The cost of the option was R500,000.

On 1 September 2010, Buffalo classified its 10% interest in Hippo Ltd as a financial asset held at fair value through other comprehensive income.

Required

Draft a memorandum to the group Financial Accountant in which you discuss

(i) Whether Buffalo controls Rhino as a consequence of acquiring additional shares in Rhino Ltd as at 31 December 2013 **[15]**

(ii) With reasons, the appropriate recognition and measurement of investment in Hippo Ltd and an option to purchase additional shares in Hippo Ltd in the consolidated financial statements of Buffalo for the year ended 31 December 2013. **[10]**

END OF EXAMINATION PAPER