



FACULTY OF BUSINESS SCIENCES AND MANAGEMENT

DEPARTMENT OF ACCOUNTING

BACHELOR OF COMMERCE HONOURS DEGREE IN ACCOUNTING

PART II FIRST SEMESTER EXAMINATION

FINANCIAL ACCOUNTING IIA [BAC2101]

APRIL 2024

DURATION: 3 HOURS

INSTRUCTIONS

1. Answer **ALL** QUESTIONS
2. Begin your answer to each question on a new page.
3. Please indicate the study format (Conventional/Block) on the cover of your answer script.

INFORMATION

1. Marks per question are as indicated.
2. Questions may be attempted in any order.

This paper consists of eleven (11) printed pages including the cover page

QUESTION 1 [30 MARKS]

1.1. The objective of general purpose financial reporting as described in the Conceptual Framework is to:

- A. Provide information to regulators.
- B. Support entity's tax return.
- C. Meet the information needs of an entity's stakeholders.
- D. Provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

[2 Marks]

1.2. How does the Conceptual Framework explain the role of stewardship?

- A. Providing information needed to assess management's stewardship is identified as an additional objective of financial reporting, equal in prominence to providing financial information useful to users in making decisions relating to providing resources to the entity
- B. Decisions relating to providing resources to the entity depend on a user's assessment of the amount, timing and uncertainty of the prospects for future net cash inflows to the entity and on their assessment of management's stewardship.
- C. Providing information needed to assess stewardship is more important than providing information needed to assess the prospects for future cash inflows to the entity.
- D. Financial reports are not intended to provide information needed to assess stewardship.

[2 Marks]

1.3. The Conceptual Framework defines a liability as:

- A. A present obligation of the entity to transfer an economic resource as a result of past events.
- B. A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
- C. An amount the entity may have to pay after the end of the reporting period.
- D. None of the above.

[2 Marks]

1.4. PB incurred the following costs in relation to the construction of its new factory and the introduction of its products to the market:

	\$000
Site preparation	1 000
Materials	1 500
Labour costs	9 000
Testing	500

Consultancy- installation	300
Relocation of staff to new site	400
General overheads	150
Dismantling costs (present value)	300

- a. In accordance with IAS 16 *Property, Plant and Equipment*, calculate the total that should be presented in PB's Statement of Financial Position. **[2 Marks]**
- A. \$12 600
 B. \$13 150
 C. \$13 000
 D. \$12 300
- b. You are advised that 15% of material costs were incurred because of poor handling of materials. Further, there was an industrial dispute which resulted in 10% of the labour costs being incurred. Calculate the total costs to be written off to the statement of profit or loss. **[2 Marks]**
- A. \$1 125
 B. \$1 525
 C. \$1 675
 D. \$1 975
- 1.5. A piece of equipment has an annual service costing \$100,000. In the most recent service it was decided to replace part of the engineering. This meant that it will work faster and produce more units of product per hour. The cost of the replacement part is \$200,000. Required: In accordance with IAS 16 *Property, Plant and Equipment*, how should this expenditure be accounted for?
- A. \$100 000 should be capitalised and \$200 000 written off to the statement of profit or loss.
 B. \$200 000 should be capitalised and \$100 000 written off in the statement of profit or loss.
 C. \$300 000 should be capitalised.
 D. \$300 000 should be written off to the statement of profit or loss. **[2 Marks]**
- 1.6. Subsequent expenditure on property, plant and equipment should only be capitalised if:
- A. It enhances the economic benefits provided by the asset.
 B. It relates to an overhaul or required major inspection of the asset.
 C. It is replacing a component of a complex asset.
 D. All of the above. **[2 Marks]**

- 1.7. Which of the following statements is true, in accordance with IAS 20, *Accounting for Government grants and disclosure of government assistance*?
- A. Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.
 - B. Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.
 - C. Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets.
 - D. All of the above. **[2 Marks]**
- 1.8. IAS 20, *Accounting for Government grants and disclosure of government assistance*, classifies grants into:
- A. Government grants.
 - B. Community grants.
 - C. Expenditure grants.
 - D. Revenue grants. **[2 Marks]**
- 1.9. IAS 23, *Borrowing Costs*, states that capitalisation of borrowing costs should commence when **all** of the following conditions are met, except:
- A. Expenditure for the asset is being incurred.
 - B. Borrowing costs are being incurred.
 - C. Activities that are necessary to prepare the asset for its intended use or sale are in progress.
 - D. Borrowings have been obtained. **[2 Marks]**
- 1.10. An entity owns two buildings, Yellow-house and Blue-house, which are currently recorded in the books at carrying amounts of \$340,000 and \$660,000 respectively. Both buildings have recently been valued as follows:
- | | |
|--------------|-----------|
| Yellow-house | \$800,000 |
| Blue-house | \$500,000 |

The entity currently has a balance on the revaluation surplus of \$100,000 which arose when Yellow-house was revalued several years ago. Blue-house has not previously been revalued.

Required: What double entry will need to be made to record the revaluations of Yellow-house and Blue-house?

- A. Dr Non-current assets \$300,000
 Dr Statement of profit or loss \$160,000
 Cr Other comprehensive income(revaluation surplus) \$460,000
- B. Dr Non-current assets \$300,000
 Dr Statement of profit or loss \$60,000
 Cr Other comprehensive income (revaluation surplus) \$360,000
- C. Dr Non-current assets \$300,000
 Cr Other comprehensive income (revaluation surplus) \$300,000

D. Dr	Non-current assets	\$300,000	
Dr	Statement of profit or loss	\$100,000	
Cr	Other comprehensive income (revaluation surplus)	\$400,000	[2 Marks]

1.11. Development expenditure is recognised as an intangible asset if, and only if an entity can demonstrate:

- A. Probable flow of economic benefit from the asset, whether through sale or internal cost savings.
- B. Intention to complete the intangible asset and use or sell it.
- C. Technical feasibility of completing the intangible asset so that it will be available for use or sale.
- D. All of the above. **[2 Marks]**

1.12. The following statements relate to the required accounting treatment of investment properties under the fair value model of IAS 40 *Investment Property*.

- i. Investment properties are not depreciated.
- ii. Investment properties must be revalued to fair value at each reporting date.
- iii. Gains and losses on revaluation of investment properties are recognised in profit or loss.

Required: Which of the above statements are true?

- A. (i) and (ii) only
- B. (ii) and (iii) only
- C. (i) and (iii) only
- D. (i), (ii) and (iii). **[2 Marks]**

1.13. QC Ltd spent \$200,000 researching new cleaning chemicals in the year ended 31 December 2023. They have also spent \$400,000 developing a new cleaning product which will not go into commercial production until next year. The development project meets the criteria laid down in IAS 38 *Intangible Assets*.

How should these costs be treated in the financial statements of QC Ltd for the year ended 31 December 2023?

- A. \$600,000 should be capitalised as an intangible asset on the statement of financial position.
- B. \$400,000 should be capitalised as an intangible asset and should be amortised; \$200,000 should be written off to the statement of profit or loss.
- C. \$400,000 should be capitalised as an intangible asset and should not be amortised; \$200,000 should be written off to the statement of profit or loss.
- D. \$600,000 should be written off to the statement of profit or loss. **[2 Marks]**

1.14. In accordance with IAS 36 *Impairment of Assets* which of the following statements are true?

- 1. An impairment review must be carried out annually on all intangible assets.
- 2. If the fair value less costs to sell of an asset exceed the carrying amount there is no need to calculate a value in use.

3. Impairment is charged to the statement of profit or loss unless it reverses a gain that has been recognised in equity in which case it is offset against the revaluation surplus.
- A. All three are correct.
B. 1 and 2 only.
C. 1 and 3 only.
D. 2 and 3 only.
- [2 Marks]**

QUESTION 2 [25 MARKS]

- a. There has been new legislation on smoking. Under the new legislation, an entity is required to install smoking rooms to its factories by 30 December 2023. The entity has not installed the smoking rooms.

Required:

Should a provision be recognised at the end of the reporting period?

- i. 31 December 2022
ii. 31 December 2023

[2 Marks]

[3 Marks]

- b. A company revalued their land from \$200,000 to \$300,000. Previously, the same land had been revalued downwards from \$260,000 to \$200,000 creating a revaluation loss of \$60,000 which was taken to profit or loss as there was no revaluation surplus as this was the first time the asset had been revalued. The profit for this year from normal day to day activities of the company before revaluation is \$300,000 and at the start of the year the retained earnings amounted to \$150,000.

Required:

Present the ledger entries and the extracts from the Statement of profit or loss and other comprehensive income and the Statement of Financial Position to show the effects of the above revaluation.

[5 Marks]

- c. GM Ltd operates as an oil exploration company in several countries. It often causes environmental damage, but cleans up only when required to do so by law. In Botswana, where the company has been contaminating the environment for several years, a law has been drafted requiring companies causing contamination to clean up. This law, which will apply retrospectively to past damage, has passed through all stages of parliament before GM's year end of 31 December 2023, but has not been signed into law yet as the President is on holiday. The President normally signs laws that are passed by parliament without question. It has been estimated that the costs of cleaning up the damage already caused will amount to \$15 million, and the damage expected to be caused in 2024 will cost \$3.5 million to repair if the law is passed.

Required:

Explain the appropriate accounting treatment of the above, under IAS 37 *Accounting for Provisions, Contingent Liabilities and Contingent Assets*. Assume all amounts are material and that the financial year ends on 31 December 2023. **[5 Marks]**

- d. BS Ltd is preparing its accounts for the year ended 31 May 2023 and is unsure how to treat the following items:
- i. The firm completed a big marketing and advertising campaign costing \$2.4m. The finance director had authorised this campaign on the basis that it would create \$5m of additional profits over the next three years.
 - ii. A new product was developed during the year. The expenditure totalled \$1 500 000 of which \$1 000 000 was incurred prior to 30 November 2022, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at \$700,000.
 - iii. Staff participated in a training programme which cost the company \$300,000. The training organisation had made a presentation to the directors of BS Ltd outlining that incremental profits to the business over the next twelve months would be \$500,000.

Required:

In accordance with IAS 38 *Intangible Assets*, explain how each of the above should be accounted for and show what amounts should appear as assets in BS Ltd's statement of financial position as at 31 May 2023? **[5 Marks]**

- e. MN Limited purchased a plant in June 2023 costing \$1,600,000. Its useful life is expected to be ten years and the residual value at the end of its useful will be \$100,000. It received a grant of 30% of the cost of the asset in August 2023 having received government approval before it purchased the plant. Any grant received becomes repayable if the asset is sold within five years. Its company policies are to depreciate in full in the year of purchase and none in the year of sale to maximise asset values.

Required:

Prepare the relevant extracts for the financial statements for the year ended 31 December 2023. **[5 Marks]**

QUESTION 3 [25 MARKS]

The following trial balance was extracted from the books of Perfect Ltd (Perfect) on 31 March 2023.

	Note	DR	CR
		\$000	\$000
Revenue			372
Cost of sales		221	
Distribution costs		46	
Administration expenses		74	
Land and buildings at valuation 1 April 2022	(i)	62	
Plant and equipment at cost	(ii)	60	
Accumulated depreciation 1 April 2022 - plant and equipment	(iii)		20
Intangible assets at cost	(iii)	30	
Financial assets at fair value 1 April 2022	(iv)	70	
Inventory at 31 March 2023		18	
Trade receivables		69	
Cash and bank		26	
Trade payables			28
Equity shares of \$1 each	(vii)		90
Share premium account			30
Revaluation surplus	(i)		10
Equity investment reserve	(iv)		15
7% Debentures	(v)		40
Suspense account	(ii)	11	
Retained earnings reserve 1 April 2022			82
		687	687

The following notes may be relevant to your answer:

- i. Perfect applies the revaluation model on IAS 16 *Property, Plant & Equipment* to its land and buildings. The revaluation surplus reserve relates entirely to previous revaluations of this category of asset. A revaluation took place on 31 March 2022 and resulted in the fair value of \$62 million shown above. This figure included \$22 million in respect of land. The buildings were deemed to have a 40-year useful economic life remaining at that date. No depreciation has yet been charged for the accounting period ended on 31 March 2023. All depreciation is charged to cost of sales. On 31 March 2023, a further revaluation took place which revealed a fair value of \$24 million for the land, and \$41 million for the buildings. This is to be recorded in the books in accordance with the accounting policy of Perfect.
- ii. Plant & equipment is being depreciated at 25% per annum straight line from the date of purchase to the date of sale. On 1 October 2022, a piece of plant was purchased at a cost

of \$12 million. This replaced another piece of plant which had cost \$8 million some years ago and was fully depreciated prior to 31 March 2022. A trade-in allowance of \$1 million was received for the old plant. The only entries made to record this transaction were to credit cash and debit suspense with the net payment of \$11 million. No other item of plant was more than three years old at 1 April 2022.

- iii. Intangible assets consist of capitalised development costs of \$30 million. These relate to products in development at 1 April 2022. No revenue has yet been earned from any of these products. They are all expected to be successful once ready for market, with the exception of one project. The amount previously capitalised in respect of this project was \$6 million. However, adverse developments have led to the decision to abandon the project as it was unlikely to be successful in the marketplace. During the year further expenditure was incurred on other qualifying projects and was charged to administration expenses. The amounts are as follows:
 - 1) Prototype development costs \$3 million
 - 2) Marketing research to determine the optimal selling strategy \$1 million
 - 3) Basic research which may lead to future projects \$4 million
- iv. The figure for financial assets represents the fair value of equities held at 1 April 2022. As permitted by IFRS 9 *Financial Instruments*, an election was made at the date of purchase to account for any fair value gains and losses on all these equity investments through “other comprehensive income”. Perfect takes such gains and losses to a separate component of equity, the equity investment reserve. The fair value of the equity investments at 31 March 2023 was \$63.5 million. No equities were purchased or sold during the year.
- v. The 7% debentures were issued on 1 April 2022 at par value. There is a premium payable on redemption which has the effect of raising the effective annual finance cost to 8.5%. Coupon interest is payable annually in arrears. No interest has been provided for or paid as at 31 March 2023.
- vi. Corporation tax for the year was estimated at \$0.5 million.
- vii. An equity dividend of \$0.06 per ordinary share was proposed before the reporting date and is expected to be approved at the next AGM. No entry has yet been made to reflect this proposal.

Required:

Prepare, in a form suitable for publication to the shareholders of Perfect Ltd the:

- a. Statement of Profit or Loss and Other Comprehensive Income for the year to 31 March 2023 **[10 Marks]**
- b. Statement of Changes in Equity for year ended 31 March 2023; **[5 Marks]**
- c. Statement of Financial Position as at 31 March 2023. **[10 Marks]**

QUESTION 4 [20 MARKS]

IAS16 *Property, Plant and Equipment* and IAS40 *Investment Property* outline the accounting treatment of tangible non-current assets. Hearty PLC is a Bulawayo based computer manufacturer and during the year ended 31 October 2023 the following transactions in relation to property, plant and equipment took place.

- i. On 1 April 2023, a new machine was purchased by Hearty PLC in order to improve productivity. The cost of the machine was \$600,000, but the company also incurred the following:

	\$
Delivery costs	4,000
Labour installation costs (Note i)	15,000
Management and supervision costs (allocated from head office)	10,000
Material costs used for the installation -inclusive of \$223 recoverable VAT	1,500
Cost of testing of new machine (Note ii)	3,000
Maintenance service contract costs per annum	400
Proceeds from sale of by-products produced as a result of the testing process	(100)

Notes:

- i. These were 20% higher than budgeted due to an industrial dispute at the time of installation.
- ii. Included in the testing costs of the machine was \$150 in connection with a quarterly diagnostic check of machinery
- iii. Plant and equipment are depreciated at 25% straight line. The cost of plant and equipment at 1 November 2022 amounted to \$300,000 and the accumulated depreciation was \$180,000 at that date.
- iv. Hearty PLC’s head office building was originally acquired on 1 November 2017 for \$2m, and is depreciated at 4% per annum straight line. On 1 November 2021, it was revalued to \$2.5m. Due to the recent downturn in commercial property prices, valuers acting for the company have advised that the valuation on 31 October 2023 should be \$2m.
- v. On 1 November 2022, Hearty PLC purchased a property in Plumtree, costing \$500,000 for its investment potential. The amount attributable to land was negligible, and the buildings are expected to have a useful life of 40 years. Local property indices indicate that property prices in this area have gone against the downward national trend, and that the fair value of the property has increased during the year to 31 October 2023.

Required:

- a. In relation to the machinery and head office building, draft the non-current asset note showing the movements on property, plant and equipment for the year to 31 October 2023. **[12 Marks]**
- b. Define the term ‘Investment Property’ and explain why it may not be appropriate to charge depreciation in relation to such a property. **[4 Marks]**

- c. Assuming that Hearty PLC adopts a fair value policy for the property in Plumtree, explain how the property would be presented in the financial statements for the year to 31 October 2023, if the property has risen in value by 5% during the year. **[4 Marks]**

END OF EXAMINATION PAPER