



FACULTY OF BUSINESS SCIENCES AND MANAGEMENT

DEPARTMENT OF ACCOUNTING

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**BACHELOR OF COMMERCE HONOURS DEGREE IN ACCOUNTING**

PART II FIRST SEMESTER EXAMINATION

**FINANCIAL ACCOUNTING IIA [BAC2101]**

SEPTEMBER 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 FOR CANDIDATES**

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

**This paper consists of nine printed pages including the cover page**

## QUESTION 1 [30 MARKS]

Please select the most appropriate answer.

1.1. Which of the following is not a basis of measurement of the elements in financial statements?

- A. Realisable value
- B. Historical costs
- C. Current cost
- D. Net current value

[2 Marks]

1.2. The going concern concept is applied unless:

- A. The company is in the early stages of its operations and has not yet achieved profitability.
- B. There is substantial doubt about the company's ability to continue operating for the foreseeable future.
- C. The company has recently changed its accounting policies and procedures.
- D. The company is operating in a highly competitive industry with fluctuating market conditions.

[2 Marks]

1.3. Which of the following does NOT contribute to the concept of faithful representation according to the Conceptual Framework?

- A. Completeness
- B. Neutrality
- C. Understandability
- D. Free from error

[2 Marks]

1.4. XYZ Corporation received a government grant of \$200,000 to support the purchase of new equipment. The grant is intended to be recognized over the useful life of the equipment, which is 10 years. The equipment was purchased and put into use on January 1, 2024.

According to IAS 20, why should XYZ Corporation account for the government grant by recognizing \$20,000 of the grant as deferred income in the financial year ended December 31, 2024, and recognizing it as income in equal annual installments over the next 10 years?

- A. To match the government grants income with the depreciation expense of the equipment over its useful life.
- B. To immediately recognize the entire grant amount in the financial statements which reflects the actual receipt of funds.
- C. To comply with the requirement to recognize government grants as a reduction in the carrying amount of the asset at the time of purchase.
- D. To comply with the requirement to recognize the grant in full at the time of purchase to align with the acquisition cost of the equipment.

[2 Marks]

1.5. Zelco Ltd reported an impairment loss of \$500,000 on its machinery in the financial year ended December 31, 2022, due to a decline in its recoverable amount. In the financial year ended December 31, 2023, the market conditions improved significantly, and the recoverable amount of the machinery increased to \$450,000. The carrying amount of the machinery before the reversal was \$600,000.

How should Zelco Ltd account for the reversal of the impairment loss in the financial year ended December 31, 2023, according to IAS 36?

- A. Zelco Ltd should reverse the entire impairment loss of \$500,000 and recognize it in profit or loss.
- B. Zelco Ltd should reverse only the portion of the impairment loss up to the amount of the increased recoverable amount, recognizing \$450,000 in profit or loss.
- C. Zelco Ltd should not reverse any of the impairment loss because the recoverable amount is still below the carrying amount.
- D. Zelco Ltd. should reverse the impairment loss by increasing the carrying amount to \$450,000, recognizing the reversal in other comprehensive income. **[2 Marks]**

1.6. In accordance with IAS 8, how should a company account for material errors discovered in prior periods?

- A. The error should be adjusted in the current period's financial statements without restating prior periods.
- B. The error should be corrected by adjusting the opening balances of retained earnings in the current period and restating the prior period's financial statements.
- C. The error should be disclosed in the notes to the financial statements of the current period without making any adjustments to prior periods.
- D. The error should be adjusted in the statement of comprehensive income for the current period as a one-time expense. **[2 Marks]**

1.7. IAS 20 Accounting for Government Grants and Disclosure of Government Assistance sets out guidance for recording grants received to assist with the purchase of capital assets (capital grants). Which of the following is true?

- i. Capital grants are credited to the asset account, thus reducing the carrying value of the asset to the cost net of grant aid; or
  - ii. Capital grants are credited to a separate deferred income account, the balance on which is amortised to profit or loss over the period the related asset is expensed to profit or loss.
- A. (i) only
  - B. (ii) only
  - C. Either (i) or (ii) is permitted
  - D. (d) Neither (i) nor (ii) is permitted **[2 Marks]**

- 1.8. Which of the following borrowing costs can be capitalized according to International Accounting Standard (IAS) 23?
- A. Interest expenses on loans taken out to finance general operations.
  - B. Interest expenses on loans specifically borrowed to purchase inventory.
  - C. Interest expenses on loans used to acquire an asset that is intended to be sold in the near term.
  - D. Interest expenses related to bonds issued for the general purposes of the company.
- [2 Marks]**
- 1.9. IAS 40 - Investment Properties sets out the accounting treatment required for properties that meet the definition of investment properties. The entity may choose the Cost Model or the Fair Value Model under IAS 40. Which of the following is correct in the case of the Fair Value Model?
- i. Depreciation is not charged on investment properties.
  - ii. Gains and losses on annual revaluations are taken to other comprehensive income.
- A. (i) only
  - B. (ii) only
  - C. Both (i) and (ii)
  - D. Neither (i) nor (ii).
- [2 Marks]**
- 1.10. Which of the following correctly defines an "error" as per IAS 8 - Accounting Policies, Changes in Accounting Estimates, and Errors?
- A. A mistake made by management when making a future projection about the financial statements.
  - B. A miscalculation that occurs when applying an accounting policy due to unforeseen market conditions.
  - C. An omission or misstatement in the financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that was available when those financial statements were authorized for issue.
  - D. A change in an accounting policy that results in a different financial outcome for the current period.
- [2 Marks]**
- 1.11. Which of the following is not a primary purpose of IAS 1 - Presentation of Financial Statements?
- A. To ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities.
  - B. To prescribe the basis for presentation of general-purpose financial statements to ensure comparability with the entity's budgetary statements.
  - C. To set out overall requirements for the presentation of financial statements, guidelines for their structure, and minimum requirements for their content.

D. To provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions.

**[2 Marks]**

1.12. According to IAS 36, which of the following would be considered an internal indicator of impairment?

- A. An increase in the carrying amount of a cash-generating unit.
- B. A significant adverse change in the technological environment in which the entity operates.
- C. A market value decline of an asset that is significantly greater than would be expected.
- D. Evidence of obsolescence or physical damage of an asset.

**[2 Marks]**

1.13. Which of the following statements regarding the amortization of intangible assets held under IAS 38 is correct?

- A. Intangible assets with indefinite useful lives are amortized over a period not exceeding 20 years.
- B. Amortization of intangible assets should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
- C. Intangible assets are amortized using only the straight-line method.
- D. Amortization expense should be recognized only when the asset is revalued.

**[2 Marks]**

1.14. Which of the following is a key term defined under IFRS 15 - Revenue from Contracts with Customers?

- A. Carrying Amount
- B. Performance Obligation
- C. Depreciation
- D. Impairment Loss

**[2 Marks]**

1.15. According to IAS 7 - *Statements of Cash Flow*, under which heading in the Statement of Cash Flows should cash payments to acquire property, plant and equipment be included?

- A. Cash Flows from Operating Activities.
- B. Cash Flows from Investing Activities.
- C. Cash Flows from Financing Activities.
- D. None of the above.

**[2 Marks]**

**QUESTION [30 MARKS]**

- a. A business purchased two rivet-making machines on 1 January 20X5 at a cost of \$15,000 each. Each had an estimated life of five years and a nil residual value. The straight line method of depreciation is used. Owing to an unforeseen slump in market demand for rivets, the business decided to reduce its output of rivets, and switch to making other products instead. On 31 March 20X7, one rivet-making machine was sold (on credit) to a buyer for \$8,000. Later in the year, however, it was decided to abandon production of rivets altogether, and the second machine was sold on 1 December 20X7 for \$2,500 cash.

**Required**

Calculate the profit or loss on disposal of the PPE.

**[5 Marks]**

- b. IFRS 15 - Revenue from Contracts with Customers requires a 5-step approach to determining the amount of revenue to be recognised by an entity.

(i) On 30 September 2023, Cresta Villa Hotel, a high market hotel in a tourist resort signed a contract to supply 500 units of product at an agreed price of \$1,000 per unit. 300 units were delivered at that date, with the remainder to be delivered on 31 December 2023. It was agreed that the customer would have extended credit terms of 12 months from the date of delivery. Cresta Villa's cost of capital is 10%.

(ii) During the year ended 30 September 2023, Cresta Villa took payment in advance for the supply of 2,000 hotel room-nights to customers at \$100 per room per night. Only 400 of these had been occupied by 30 September 2023. The amounts paid by the customers are non-refundable unless the company fails to provide the agreed accommodation.

Assume Cresta Villa has decided to adopt IFRS 15 for the year ended 30 September 2023.

**Required**

In each scenario above, calculate the amount of revenue to be recognised in the financial statements of Cresta Villa for the year ended 30 September 2023. Show the journal entries required to record each transaction. **[7 Marks]**

- c. *IAS23 - Borrowing Costs* sets out the conditions that must be met in order to capitalise borrowing costs incurred by entities purchasing or constructing non-current assets.

**Required:** Discuss the conditions that must be met in order to capitalise borrowing costs under *IAS 23 - Borrowing Costs*. Your answer should set out when the capitalisation of borrowing costs should commence, be suspended, and cease. **[6 Marks]**

- d. *IAS 38 Intangible Assets* sets out the principles of accounting for the recognition and measurement of intangible assets.

Haddon n Sally Entertainment (H&S) has entered into the following transactions during the financial year ended 31 March 2023. The company seeks to maximise the reported value of its assets wherever possible.

(i) On 1 April 2022, H & S acquired, from a bankrupt competitor, a license to provide radio broadcast services. This license would have been originally issued by the government for a ten-year period at zero cost, but has a market value due to its exclusivity. The cost of the license to H & S was \$3.3 million, and the remaining useful economic life was 6 years.

(ii) On 1 April 2022, H & S commenced work on developing a new technology to enhance the quality of the radio broadcasts. It purchased a number of patents at a cost of \$2 million and spent a further \$6 million developing the technology, as well as \$2 million researching the international market for the technology in advance of its launch. The directors of H&S were confident throughout the development process that the technology had massive potential to generate future economic benefit. On 31 March 2023, this opinion was validated when a rival broadcaster offered H & S \$15 million for its partially developed technology project.

(iii) As a result of H & S growing reputation in the broadcasting industry, the directors commissioned a consulting firm to value its brand name. The brand name has not been recognised as an asset in the financial statements to date. On 31 March 2023, the consultants issued a report stating that the fair value of the H & S brand was \$20 million.

(iv) H & S has a portfolio of patents it developed over the past few years. These represent technologies and processes used in the company's business to generate economic benefits. The total carrying value of these patents was \$2.8 million at 1 April 2022. They originally had a 15-year useful economic life, but on average seven years remain to their expiry date. The directors propose, at 31 March 2023, to revalue this portfolio to its estimated fair value of €5 million.

### **Required**

In each of the scenarios (i) to (iv) above, prepare brief notes for H&S' financial controller advising on the appropriate accounting treatment for the intangible assets for the year ended 31 March 2023.

**[12 Marks]**

### **QUESTION 3 [20 MARKS]**

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* sets out the accounting treatment and disclosures for these transactions and events.

The following situations have arisen during the preparation of the draft financial statements of Power Corp (PC) for year ended 31 July 2023:

- i. On 1 August 2022, PC acquired a nuclear power plant at a cost of \$200 million. Part of the arrangement was that the plant be dismantled and the site restored after its useful economic life of 20 years had passed. The cost of restoration was estimated on 1 August

2022, after discounting to present value, to be \$40 million. This amount reflected an appropriate discount rate of 6%, (75% of this estimate related to the dismantling of the plant, and 25% to the removal of waste fuel).

On 31 July 2023, due to regulatory and other obstacles, no power had yet been produced hence no waste fuel had been generated.

- ii. During the year ended 31 July 2023, PC decided to close both its coal burning power generating plants in October 2023. This decision had been announced publicly, and a detailed formal plan prepared. The plan proposes to make 75 employees redundant, retrain 25 other staff to work in the nuclear plant, and sell the coal-fired plants in their current condition. It is anticipated that the redundancy costs will amount to \$7.5 million, and the retraining will cost \$1 million. The coal plants will be disposed of for zero consideration as the new owner will be expected to dismantle the plants and clean up the sites. The carrying value of these plants is \$12 million at 31 July 2023.

### Required

- a) Discuss the accounting treatment in relation to provisions, contingent liabilities and contingent assets required by IAS 37. **[8 Marks]**
- b) In the case of (i) and (ii) above, set out the appropriate accounting treatment as at 31 July 2023, applying IAS 37 and other relevant standards. **[12 Marks]**

### QUESTION 4 [20 MARKS]

#### Trial Balance for Iron and Steel Ltd as at 31 December 2023

	Dr \$	Cr \$
Sales Revenue		800,000
Cost of Goods Sold	400,000	
Administrative Expenses	60,000	
Research and Development Costs	50,000	
Land (at cost)	200,000	
Building (at cost)	500,000	
Accumulated Depreciation – Building		150,000
Machinery (at cost)	300,000	
Accumulated Depreciation – Machinery		90,000
Investment Property	200,000	
Accumulated Depreciation - Investment Property		40,000
Inventory	80,000	
Accounts Receivable	60,000	
Cash and Cash Equivalents	30,000	
Accounts Payable		70,000
Bank Loan		400,000
Share Capital		500,000

Retained Earnings		180,000
Impairment Loss on Machinery	30,000	
Gain on Disposal of Investment Property		20,000
<b>Totals</b>	1,910,000	1,910,000

Iron and Steel Ltd has provided the following additional information for the year ended 31 December 2023:

1. The company revalued its building on December 31, 2023. The fair value of the building is now \$550,000.
2. Depreciation on the building is calculated on a straight-line basis over 25 years with no residual value. The building was acquired on January 1, 2018.
3. The machinery is depreciated on a straight-line basis over 10 years with no residual value. The machinery was acquired on January 1, 2020.
4. The company disposed of an investment property on December 31, 2023, for \$200,000. The original cost was \$150,000, and it was acquired on January 1, 2020. The investment property was being depreciated on a straight-line basis over 20 years with no residual value.
5. Research and development costs incurred in 2023 amounted to \$50,000, of which \$20,000 relates to development costs that meet the criteria for capitalization under IAS 38.
6. An impairment review was conducted on December 31, 2023, and it was determined that the recoverable amount of the machinery is \$210,000.

### Required

Prepare the Statement of Profit or Loss and Other Comprehensive Income for Iron and Steel Ltd for the year ended 31 December 2023. **[20 Marks]**

**END OF EXAMINATION PAPER**