WOMEN'S UNIVERSITY IN AFRICA

Addressing gender disparity and fostering equity in University Education

FACULTY OF MANAGEMENT AND ENTREPRENEURIAL SCIENCES

BACHELOR OF ACCOUNTING SCIENCE HONOURS DEGREE

MAIN PAPER

BAS211: ADVANCED FINANCIAL ACCOUNTING

INTAKE 11: SECOND YEAR FIRST SEMESTER

TIME: 2 HOURS

INSTRUCTIONS TO CANDIDATES

Answer any **three** questions.

Question 1

On 1 January 2020 Dargent Co acquired 75% of Latree Co's equity shares by means of a share exchange of two shares in Dargent Co for every three Latree Co shares acquired. On that date, further consideration was also issued to the shareholders of Latree Co in the form of a $100 8% loan note for every 100 shares acquired in Latree Co. None of the purchase consideration, nor the outstanding interest on the loan notes at 31 March 2020, has yet been recorded by Dargent Co. At the date of acquisition, the share prices of Dargent Co and Latree Co are $3.20 and $1.80 respectively.

The summarized statements of financial position of the two companies as at 31 March 2020 are:

	Dargent Co	**Latree Co**
	$000	**$000**
Assets		
Non-current assets		
Property, plant and equipment (note (i))	75,200	31,500
Investment in Amery Co at 1 April 2020 (note (iv))	4,500	nil
	79,700	31,500
Current assets		
Inventory (note (iii))	19,400	18,800
Trade receivables (note (iii))	14,700	12,500
Bank	1,200	600
	35,300	31,900
Total assets	**115,000**	**63,400**
Equity and liabilities		
Equity shares of $1 each	50,000	20,000
Retained earnings – at 1 April 2020	20,000	19,000
– for year ended 31 March 2020	16,000	8,000
	86,000	47,000
Non-current liabilities		
8% loan notes	5,000	nil
Current liabilities (note (iii))	24,000	16,400
Total equity and liabilities	**115,000**	**63,400**

The following information is relevant:

1. At the date of acquisition, the fair values of Latree Co's assets were equal to their carrying amounts. However, Latree Cooperates a mine which requires to be decommissioned in five years' time. No provision has been made for these decommissioning costs by Latree Co. The present value (discounted at 8%) of the

decommissioning is estimated at $4m and will be paid five years from the date of acquisition (the end of the mine’s life).

2. Dargent Co’s policy is to value the non-controlling interest at fair value at the date of acquisition. Latree Co’s share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.
3. The inventory of Latree Co includes goods bought from Dargent Co for $2.1m. Dargent Co applies a consistent mark-up on cost of 40% when arriving at its selling prices. On 28 March 2020, Dargent Co despatched goods to Latree Co with a selling price of $700,000. These were not received by Latree Co until after the year-end, and so have not been included in the above inventory at 31 March 2020.

4. At 31 March 2020, Dargent Co’s records showed a receivable due from Latree Co of $3m. This differed to the equivalent payable in Latree Co’s records due to the goods in transit.
5. The intra-group reconciliation should be achieved by assuming that Latree Co had received the goods in transit before the year-end.
6. The investment in Amery Co represents 30% of its voting share capital and Dargent Co uses equity accounting to account for this investment. Amery Co’s profit for the year ended 31 March 2020 was $6m and Amery Co paid total dividends during the year ended 31 March 2020 of $2m. Dargent Co has recorded its share of the dividend received from Amery Co in investment income (and cash).
7. All profits and losses accrued evenly throughout the year.
8. There were no impairment losses within the group for the year ended 31 March 2020.

Required:
Prepare the Consolidated Statement Of Financial Position for Dargent Co as at 31 March 2020. [25]

Question 2

On 1 January 2020, Viagem acquired 90% of the equity share capital of Greca in a share exchange in which Viagem issued two new shares for every three shares it acquired in Greca. Additionally, on 31 December 2020, Viagem will pay the shareholders of Greca $1.76 per share acquired. Viagem's cost of capital is 10% per annum. The deferred consideration has not yet been recorded by Viagem.

At the date of acquisition, shares in Viagem and Greca had a stock market value of $6.50 and $2.50 each, respectively.

Statements of Profit or Loss for the year ended 30 September 2020

	Viagem	**Greca**
	$000	**$000**
Revenue	64,600	38,000
Cost of sales	(51,200)	(26,000)
Gross profit	13,400	12,000
Distribution costs	(1,600)	(1,800)
Administrative expenses	(3,800)	(2,400)
Investment income	500	nil
Finance costs	(420)	nil
Profit before tax	8,080	7,800
Income tax expense	(2,800)	(1,600)
Profit for the year	5,280	6,200
Equity as at 1 October 2019		
Equity shares of $1 each	30,000	10,000
Retained earnings	54,000	35,000

The following information is relevant:

1. At the date of acquisition, the fair values of Greca's assets were equal to their carrying amounts with the exception of two items:

   An item of plant had a fair value of $1.8 million above its carrying amount. The remaining life of the plant at the date of acquisition was three years. Depreciation is charged to cost of sales.

   Greca had a contingent liability which Viagem estimated to have a fair value of $450,000. This has not changed as at 30 September 2020. Greca has not incorporated these fair value changes into its financial statements.
2. Viagem's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, Greca's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.
3. Sales from Viagem to Greca throughout the year ended 30 September 2020 had consistently been $800,000 per month. Viagem made a mark-up on cost of 25% on these sales. Greca had $1.5 million of these goods in inventory as at 30 September 2020.
4. Viagem's investment income is a dividend received from its investment in a 40% owned associate which it has held for several years. The underlying earnings for the associate for the year ended 30 September 2020 were $2 million.
5. Although Greca has been profitable since its acquisition by Viagem, the market for Greca's products has been badly hit in recent months and Viagem has calculated that the goodwill has been impaired by $2 million as at 30 September 2020.

Required:

a) Calculate the consolidated goodwill at the date of acquisition of Greca. [8]

b) Prepare the Consolidated Statement of Profit or Loss for Viagem for the year ended 30 September 2020. [17]

Question 3

a) The following are three companies which Eazynet Limited is considering possible investment in and some of the key ratios for each company are listed. The three companies operate in the agribusiness industries providing feed, fertilizer and hardware to the farming community.

	Aye Ltd.	**Bee Ltd.**	**Cee Ltd.**
Gross Profit Margin	10%	24%	18%
Net Profit Margin	5%	6%	8%
Trade Receivables Days	20	44	36
Trade Payable Days	40	52	30
Inventory Days	28	60	16
Current Ratio	1.8:1	2.1:1	2.3:1
Quick Ratio	1.4:1	1.2:1	1.6:1
Gearing Ratio	50%	74%	36%
Interest Cover	2.8 times	2.1 times	3.9 times
Return on Capital Employed	5%	4%	9%

Required:

a) Prepare a report to the financial controller of Eazynet Limited in which you evaluate the three companies and their results and propose a recommendation as regards which company Econet Limited should invest in, with supporting reasons. [19]

b) With use of an examples, explain the information that is provided by each of the following ratios

(i) Gearing Ratio. [3]

(ii) Earnings per Share. [3]

Question 4

a) Carltown Ltd, a technology equipment supply company, entered into a contract with a customer on 1 December 2017 to supply, install and service a system of computers. The agreed price was $200 000, to include a two-year service contract. Payment was made in total following installation in January 2018.

At 31 December 2017, Carltown had supplied all the machines, but had not yet installed any. Installation happened in January 2018. The directors of Carltown estimated that the computers would be sold for $150 000 on a stand-alone basis. Installation would cost $20 000, and the two-year service contract would cost $50 000 if purchased separately.

Required:

a) Advise, showing relevant journal entries, how the above transaction should be recognized in Carltown's financial statements for years ended 31 December 2017 and 2018. [15]

b) Shipton Ltd, a professional services company, provided estate management services for a customer, completed on 30 September 2017. The agreed price was $50,000. The customer paid $10,000 on completion on 30 September 2017. It was agreed that the customer would pay the remainder 12 months later, on 30 September 2018. Shipton's cost of capital is 7%.

Required:

Advise, showing relevant journal entries, how the above transaction should be recognized in Shipton's financial statements for the year ended 31 December 2017 and 2018. [10]

Question 5

a) On 1 January 2020, Painting sells an item of machinery to Collage for its fair value of $3 million. The asset had a carrying amount of $1.2 million prior to the sale. This sale represents the satisfaction of a performance obligation, in accordance with IFRS 15 *Revenue from Contracts with Customers*.

b) Painting enters into a contract with Collage for the right to use the asset for the next five years. Annual payments of $500,000 are due at the end of each year. The interest rate implicit in the lease is 10%.

The present value of the annual lease payments is $1.9 million. The remaining useful life of the machine is much greater than the lease term.

Required:

Explain how Painting will account for the transaction on 1 January 2020. [20]

b) Shaeen Ltd entered into an agreement to lease an item of plant on 1 October 2020. The lease required four annual payments of $200,000 each, commencing on 1 October 2020. The plant has a useful life of four years and is to be scrapped at the end of this period. The present value of the lease payments is $700,000. The implicit interest rate within the lease is 10%.

Required:

Prepare extracts of the financial statements in respect of the leased asset for the year ended 31 March 2020 [10]

c) Riyad enters into an agreement to lease an asset. The terms of the lease are as follows.

i. 1 Primary period is for four years from 1 January 2020 with a rental of $2,000 pa payable on 31 December each year.
ii. 2 The present value of the lease payments is $5,710
iii. 3 The interest rate implicit in the lease is 15%.

Required:

Show the figures that will be shown in the financial statements for the year ended 31 December 2020 [8]

Question 6

a) The International Accounting Standards Board's (The Board's) Conceptual Framework for Financial Reporting identifies two fundamental and four enhancing qualitative characteristics of financial information.

Required:

Identify and explain each of the two fundamental and FOUR enhancing qualitative characteristics of financial information listed in the Board's Framework. [10]

b) The Conceptual Framework for Financial Reporting has a number of purposes, including assisting assisting the Board in promoting harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative treatments permitted by IFRS Standards assisting preparers of financial statements in applying IFRS Standards and in dealing with topics that are yet to be covered in an IFRS Standard.

Required:

a) Discuss how the Conceptual Framework could help the board achieve these objectives. [6]

b) Explain the purposes of the Conceptual Framework. [5]

END