

THE INSTITUTE OF BANKERS OF ZIMBABWE

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INTERMEDIATE LEVEL	
SUBJECT	FINANCIAL ACCOUNTING II
DATE	23 OCTOBER 2017
TIME	3 HOURS
MARKS	100
EXAM TYPE	CLOSED BOOK
READING TIME	TEN MINUTES READING TIME IS ALLOWED FOR THIS PAPER. DURING THIS TIME YOU ARE PERMITTED TO WRITE ON THE QUESTION PAPER BUT NOT IN YOUR ANSWER BOOK
EQUIPMENT REQUIREMENTS	SILENT HANDHELD CALCULATOR

INSTRUCTIONS TO CANDIDATES

1. Read the instructions **CAREFULLY** before answering the paper
2. Answer all questions
3. Use black or blue ink
4. Ensure that all information on the cover of your answer book is completed in full.
5. Cheating is not allowed. If anyone is caught cheating, disciplinary measures will be taken by the Institute of Bankers.

GOOD LUCK !

INSTITUTE OF BANKERS

OF

ZIMBABWE

OCTOBER 2017 EXAMINATIONS

FINANCIAL ACCOUNTING 2

QUESTION NUMBER	TOPIC	MARKS
1	FINANCIAL STATEMENTS	
1A	- Adjustments to equity accounts and financial statements of a partnership	16
1B	- IAS 1: Presentation of financial statements: Financial statements of a company	9
2	VARIOUS IFRS's	
2A	- IAS 10 Events after reporting period	8
2B	- IAS 12 Income taxes	10
2C	- IAS 33 Earnings per share	7
3	GROUP FINANCIAL REPORTING	
	- IFRS 3 Business combinations, and IFRS 10 Consolidated financial statements	25
4	ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS	
4A	- IAS 7 Statement of cash flows	17
4B	- Financial ratio analysis	8
	TOTAL	<u>100</u>

QUESTION 1 [25 MARKS]

Part 1A (16 marks)

Mara and Feso operated a partnership business Mafe Traders. They shared profits in the ratio 3:2. The following is the trial balance of Mafe Traders at 31 August 2017.

	Debit \$	Credit \$
Land and buildings at cost	114 000	
Machinery at cost	20 000	
Accounts receivable	30 800	
Inventory	14 000	
Cash at bank	72 400	
Interest bearing borrowings		16 000
Accounts payable		28 200
Accrued expenses		2 400
Accumulated depreciation:		
– Machinery		4 000
Capital accounts		
Mara		56 000
Feso		65 000
Current accounts		
Mara		41 708
Feso		25 892
General reserve		12 000
	<u>251 200</u>	<u>251 200</u>

On 1 September 2017 Mara and Feso agreed to admit Sipo into the partnership on the following terms;

i) The following values were placed on the partnership assets and liabilities:

	\$
Land and buildings	140 000
Machinery	18 000
Inventory	13 000
Accounts receivable	28 800
Goodwill	38 400

All other assets and liabilities were considered to be fairly valued.

- ii) Sipo contributed \$88 000 to the partnership, and will be entitled to a one third share of partnership profits. Mara and Feso are to relinquish shares of profit in such a way that each partner will have a third of the future profits.
- iii) The new partnership agreed to maintain
- the assets at the revalued amounts
 - a goodwill account, and
 - the general reserve account
- iv) The new partnership will trade under the new name of Mafesi Traders.

Required

- i) Show the adjustments to the profit-sharing ratio resulting from the admission of Sipo. (2 ½ marks)
- ii) Prepare the revaluation account. (3 marks)
- iii) Calculate net adjustments to capital accounts as a result of changes in proportionate interest in general reserve. (2 ½ marks)
- iv) Prepare an extract of the Statement of Changes in Equity of Mafesi Traders for the year ending 31 August 2018 showing the changes in equity arising from the admission of Sipo. Omit partners' current accounts and total columns (4 marks)
- v) Prepare an extract of the Statement of Financial Position of Mafesi Traders showing only the assets section immediately after the admission of Sipo. (4 marks)

Part B (9 marks)

The following is an extract of the trial balance of the F. Sitee Limited Group

F. Sitee Limited Group Trial balance (extract) as at 30 September 2017

	Debit \$	Credit \$
Advertising costs	44 400	
Delivery costs	66 300	
Income tax expense	1 030 780	
Profit on expropriation of land		150 000
Dividend paid	240 000	
Dividend income		21 000
Rental income		9 000
Share of profit of joint venture		450 000
Goodwill impairment loss	18 000	
Cost of sales	3 139 800	
Non-controlling interest in profit for the year	135 300	
Interest expense	99 900	
Salaries:		
Administrative staff	281 400	
Sales staff	252 600	
Stationery	33 000	
Sales		6 033 600
Depreciation expense:		
Delivery vehicles	80 100	
Office buildings	24 600	
Non-controlling interest (cumulative)		284 175
Retained earnings (01 October 2016)		900 000
Revaluation surplus net of tax (01 October 2016 \$NIL) parent only		64 125
Ordinary share capital		465 000

Required

Prepare the following financial statements of the Sitee Limited Group for the year ended 30 September 2017.

- a) Consolidated statement of profit or loss and other comprehensive income. (6 marks)
- b) Consolidated statement of changes in equity. (3 marks)

QUESTION 2 [25 MARKS]**Part A (8 marks)**

The financial statements of P. Ripo Limited for the year ended 31 August 2017 were presented to the board of directors for authorisation for issue on 18 November 2017. The following events occurred after 31 August 2017.

- i) As a result of the current economic environment and competitive pressures, P. Ripo Limited reduced the selling price of its main product considerably on 20 October 2017. The lower selling price will result in a 25% decrease in the gross profit of the main product, and a before tax decrease of \$750 000 in the company's total comprehensive income for the year ending 31 August 2018.
- ii) On 20 October 2017, the board of directors decided to declare a dividend of \$30 000. The dividend will be paid on 10 December 2017.
- iii) On 14 November 2017, S. Tepi Limited, a debtor, sent a letter to its creditors stating that the company was terminating business as a result of financial difficulties. S. Tepi Limited indicated that the company was only able to pay its creditors 25c in a dollar. The letter was accompanied by a statement of assets and liabilities certified by the company's auditors. S. Tepi Limited owed P. Ripo \$10 000.
- iv) On 26 October 2017, a fire broke out in the warehouse. Inventory amounting to \$32 000 was destroyed. The inventory was not insured. The loss resulting from the inventory damage was tax deductible. (Assume a tax rate of 25%)
- v) On 28 September 2017, a customer sued P. Ripo Limited for failing to meet specifications on goods that the company supplied. The company's lawyers are of the opinion that the company will probably lose the case. The costs related to the case, including compensation are estimated at \$56 000. These costs are tax deductible. The goods which were the subject of the litigation were delivered during the year ended 31 August 2017.

Required

- a) Explain the terms
 - i) Events after reporting period
 - ii) Adjusting events and
 - iii) Non-adjusting events (3 marks)
- b) In each of the above cases, indicate whether an adjusting or non-adjusting event took place. (2 ½ marks)

- c) State the effect of each of the events on the financial statements as at 31 August 2017.
(2 ½ marks)

Part B (10 marks)

On 1 October 2013 Inka Limited bought manufacturing plant for \$250 000 and immediately put it into production. Inka decided to depreciate the plant over its useful life of five years using the straight line method. The plant had an estimated residual value of \$Nil.

For tax purposes ZIMRA allowed wear and tear on the following basis;

First year	50%
Second year	30%
Third year	20%

On 30 September 2017, Inka Limited sold the plant for \$50 000.

The profit before tax for the financial years ended 30 September 2016 and 2017 were \$60 000 and \$75 000 respectively. The tax rate was constant at 30 % since the plant was purchased.

Inka Limited reviewed the residual value, useful life and depreciation method of the manufacturing plant each year and there were no changes.

For the years ended 30 September 2016 and 2017, Inka Limited made provisional tax payments of \$15 000 and \$50 000 respectively.

Ignore capital gains tax.

Required

- Calculate the temporary differences and deferred tax asset/liability for the years ended 30 September 2015 and 2016, 2017 (3 marks).
- Calculate the taxable income and current tax expense for the years ended 30 September 2017 and 2016 (3 marks).
- Present relevant extracts of
 - the Statement of financial position at 30 September 2017 (2 marks), and
 - the Statement of profit or loss for the year end 30 September 2017 (2 marks).

Present financial statement in conformity with relevant IFRS's.

Part C (7 marks)

The following is an extract of the income statement of the EPS Limited for the year ended 30 September:

	2017	2016
	\$	\$
Gross profit	550 000	387 500
Share of profit/loss of associates	76 430	(10 360)

Profit before tax	626 430	377 140
Income tax expense	(187 430)	(113 140)
Profit for the year	439 000	264 000
Profit attributable to:		
Owners of the parent	395 000	238 000
Non-controlling interest	44 000	26 000
	439 000	264 000

Additional information

1. EPS Limited paid the following dividends for the years ended 30 September:

	2017	2016
	\$	\$
Preference dividend	32 000	32 000
Ordinary dividend	200 000	138 000
	232 000	170 000

2. Over the two year period ended 30 September 2017, EPS made the following issues of ordinary shares.

- On 1 October 2015, EPS issued 2 000 000 ordinary shares for fair value.
- On 1 March 2016, EPS issued an additional 321 000 in order to obtain the total issued share capital of Tinda (Pvt) Ltd with effect from 28 February 2015.
- On 26 September 2017, EPS made a capitalisation issue of one ordinary share for every two ordinary shares held on that date.

Required

- Calculate the basic earnings per share of EPS Limited for the years ended 30 September 2017 and 2016. (5 marks)
- Present the basic earnings per share of EPS Limited on the Statement of profit or loss and other comprehensive income for the year ended 30 September 2017. (2 marks)

Notes to financial statements are not required.

QUESTION 3 [25 MARKS]

Part A (20 marks)

The following are financial statements of HM Limited and SB Limited

Statements of profit or loss and other comprehensive income for the year ended 31 August 2017

	HM Limited	SB Limited
	\$	\$
Sales	1 137 000	1 918 000
Cost of sales	(758 000)	(1 370 000)
Gross profit	379 000	548 000
Dividend from SB Limited	48 000	-
Operating expenses	(250 000)	(338 000)

Share of profit of associate	6 000	-
Profit before tax	183 000	210 000
Income tax expense	(54 000)	(60 000)
Profit for the year	129 000	150 000
Other comprehensive income	-	-
Total comprehensive income	129 000	150 000

Statement of financial position as at 31 August 2017

	HM Limited	SB Limited
	\$	\$
ASSETS		
Property, plant and equipment	92 000	150 000
Investment:		
- SB Limited – 96 000 ordinary shares	165 000	-
- Assosi Limited – 16 000 ordinary shares	28 000	-
Inventory	67 500	82 500
Accounts receivable	127 500	112 500
	<u>480 000</u>	<u>345 000</u>
EQUITY AND LIABILITIES		
Issued share capital		
- Ordinary shares of \$1.00 each	150 000	120 000
Retained earnings	187 500	180 000
Interest bearing borrowings	37 500	-
Accounts payable	105 000	45 000
	<u>480 000</u>	<u>345 000</u>

Statement of changes in equity (extract) for the year ended 31 August 2017

	Retained Earnings	
	HM Limited	SB Limited
	\$	\$
Balance at 31 August 2016	112 500	90 000
Total comprehensive income	129 000	150 000
Ordinary dividend	(54 000)	(60 000)
Balance at 31 August 2017	<u>187 500</u>	<u>180 000</u>

Additional information

- HM Limited acquired its interest in SB Limited on 1 January 2013. At that date SB Limited's share capital and reserves were as follows:

	\$
Issued ordinary share capital	120 000
Retained earnings	67 500

- HM Limited acquired its interest in Assosi Limited on 31 May 2013. At that date the issued share capital and reserves of Assosi Limited were as follows:

	\$
Issued share capital	64 000
Retained earnings	12 000

3. HM Limited purchased some of its inventory from SB Limited since 01 August 2013. SB Limited supplies inventories at cost plus 50% mark up. During the year ended 31 August 2017 total sales from SB Limited to HM Limited amounted to \$300 000. The inventory on hand of HM Limited, purchased from SB Limited are summarised below:

	\$
On 31 August 2016	12 000
On 31 August 2017	15 000

Required

Prepare the following for the HM Limited Group:

- Adjusting journal entries for intra group transactions (4 marks)
- Analysis of shareholders interest in SB Limited (5 marks)
- Consolidated statement of profit or loss and other comprehensive income for the year ended 31 August 2017 (6 marks)
- Consolidated statement of changes in equity for the year ended 31 August 2017 (4 marks)
- Consolidated statement of financial position as at 31 August 2017 (6 marks)

QUESTION 4 [25 MARKS]

Part A (16 marks)

The following are summarised financial statements of Keshi Limited

Keshi Limited
Statement of profit or loss and other comprehensive income
for the year ended 31 August

	\$
Sales	550 000
Cost of sales	<u>(200 000)</u>
Gross profit	350 000
Other income:	
- Profit on sale of property, plant and equipment	15 000
- Dividend income	6 000
Operating expenses	<u>(277 500)</u>
Interest expense	<u>(11 500)</u>
Profit before tax	82 000
Income tax expense	<u>(28 000)</u>
Profit for the year	<u>54 000</u>
Other comprehensive income:	
Revaluation surplus	<u>100 000</u>
Total comprehensive income	<u>154 000</u>

Keshi Limited

Statement of financial position as at 31 August 2017

	2017	2016
	\$	\$
ASSETS		
Property, plant and equipment	700 000	350 000
Long term investments	99 000	7 500
Inventory	99 250	46 500
Accounts receivable	96 250	125 000
Prepaid expenses	1 000	2 000
Dividend receivable	6 000	-
Cash and cash equivalents	-	27 500
Total assets	1 001 500	558 500

EQUITY AND LIABILITIES

Equity

Share capital:

Ordinary shares of \$1.00 each	500 000	200 000
Share premium	-	25 000
Revaluation reserve: on land	137 500	37 500
Retained earnings	187 750	162 500

Liabilities

10% debentures	20 000	55 000
18% long term loan	15 000	20 000
Deferred tax liability	2 500	6 000
Short term portion of long term loan	5 000	5 000
Current tax liability	7 000	17 000
Shareholders for dividend	28 750	10 000
Accounts payable	12 500	20 500
Bank overdraft	85 500	
Total equity and liabilities	1 001 500	558 500

Additional information

- i) Property, plant and equipment at August 2017 and 2016 consisted of land, and plant and equipment as follows:

	At 31 August			
	2017		2016	
	Land	Plant and equipment	Land	Plant and equipment
	\$	\$	\$	\$
Cost/evaluation	337 500	450 000	200 000	200 000
Accumulated depreciation	-	(87 500)	-	(50 000)
	337 500	362 500	200 000	150 000

- ii) Operating expenses for the year ended 31 August 2017 included depreciation expense on plant and equipment of \$97 500.
- iii) During the year ended 31 August 2017 Keshi Limited sold plant and equipment with a carrying amount of \$90 000 and purchased plant and equipment. \$250 000 of the purchase cost of plant and equipment represented replacement of assets disposed of.

- iv) New long term investments were purchased during the year ended 31 August 2017.
- v) On 1 October 2016, 250 000 ordinary shares were issued to the public at a premium of 10%. On 31 December 2016, the company issued capitalisation shares at par to ordinary shareholders in the ratio of one ordinary share for every nine shares held. The company utilised the share premium for this purpose.
- vi) Total dividends of \$28 750 were declared for the year ended 31 August 2017.

Required

Prepare the Statement of Cash Flows of Keshi Limited for the year ended 31 August 2017. Use the direct method to determine cash generated by operations.

Part B (9 marks)

You are an investment banker. The following information was extracted from the financial records of Peno Limited, a prospective investment opportunity.

Peno Limited
Extracts from financial records at 30 September 2017

	\$
Revenue	400 000
Cost of sales	320 000
Gross profit	80 000
Total expenses	48 000
Profit for the year	32 000
Credit purchases	160 000
Inventory	4 000
Current assets	13 000
Average trade accounts payable	21 600
Total assets	60 000
Current liabilities	14 400
Total liabilities	44 000

Your bank uses the following criteria to make investment decisions in the sector of the prospective opportunity.

- i) Profitability
 - A net profit percentage of at least 5%
- ii) Liquidity
 - Current ratio of around 2:1
 - Acid test ratio of around 1:1
- iii) Solventy
 - Debt to equity ratio of at least 1:1
- iv) Activity
 - Suppliers payment period of less than 60 days

Required

Using the following table:

- Calculate the particular ratios of Peno Limited, and
- Based on your calculations and the bank's criteria, comment on whether or not you would support an investment in Peno Limited;

Financial ratio	Formula	Calculation	Bank criteria	Comment
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Overall comment: