THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ZIMBABWE

Initial Test of Competence
Professional Paper 3

JUNE 2016

TOTAL MARKS – 100
READING TIME – 30 minutes
WRITING TIME – 150 minutes

INSTRUCTIONS TO CANDIDATES

1 Enter your examination number on the front of the answer book. Your name must not appear anywhere.
2 You are reminded that answers may **NOT** be written in pencil.
3 The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and the required depth of the answer.
   - **Even if it is not explicitly required, you should show workings and cross-reference them to your answer.**
   - Marks are awarded for appropriate arrangement and layout, clarity of explanation, logical argument and clear and concise language.

4 Working papers must be handed in with scripts.

Disclaimer clause: All names of persons, places and business entities mentioned in this examination paper are fictitious and any resemblance to real persons, living or dead, places and business entities are purely coincidental.

NOTES
1 The questions in this paper are not intended to reflect the reality of the Zimbabwean economy. Hence reference to exchange rates, interest rates, return on capital, inflation, etc., are to be taken at face value and there is an assumption that financial instruments such as foreign exchange contracts will be freely available. Where necessary, an effective tax rate of 25,75% should be used
2 Any proposed amendments to tax legislation from the National Budget announced in November 2015 ARE NOT EXAMINABLE in this ITC.

QUESTION 1 **100 marks**

Ignore value-added tax.

Investment Holdings Ltd ('Investhold') is a company listed on the Zimbabwe Stock Exchange. Investhold is the holding company of a number of other companies. Investhold also has interests in associates. All of these are incorporated and domiciled in Zimbabwe and operate predominantly in the food sector. Investhold's major shareholders are its chairman, its chief executive officer, an indigenisation partner, fund managers and large institutional investors.

All entities within the Investhold group have a 30 April financial year end. The consolidated financial statements in respect of the 2016 financial year ('FY2016') are due to be approved on 10 July 2016.

You have been provided with the following information relating to selected entities in the Investhold group in respect of FY2016. In addition, the draft consolidated financial statements of the Investhold group for FY2016 are attached as appendices A and B as follows:

Appendix A	Draft consolidated statement of profit or loss and other comprehensive income of the Investhold group
Appendix B	Assets and liabilities sections extracted from the draft consolidated statement of financial position of the Investhold group

While these consolidated financial statements have not yet been finalised, all amounts correctly reflect and include the effects of the information provided in sections 1 to 5 below.

1 The Fishing Company Ltd

The Fishing Company Ltd ('TFC') is a fishing and commercial cold storage business. TFC's fishing rights currently entitle it to the following approximate market share in different seafood species as follows:

- Hake (25%);
- Anchovies (15%); and
- Pilchards (50%).

Investhold acquired control of TFC during FY2001 when it acquired 85% of the outstanding ordinary share capital on the incorporation of TFC for \$17 million. Investhold acquired the remaining 15% of TFC's outstanding ordinary share capital for \$45 million on 1 July 2015. This amount was settled immediately in cash.

The ordinary shareholders' equity of TFC can be summarised as follows:

	\$'000
Ordinary shareholders' equity on 1 May 2015	**335 000**
Profit for the two-month period to 30 June 2015	17 600
Dividend declared and paid on 8 June 2015	(12 500)
Ordinary shareholders' equity on 30 June 2015	**340 100**
Profit for the ten-month period to 30 April 2016	68 190
Revaluation gains relating to buildings	14 000
Deferred tax on revaluation gains	(3 920)
Dividend declared and paid on 1 April 2016	(10 000)
Ordinary shareholders' equity on 30 April 2016	**408 370**

2 Marine Ltd

Marine Ltd ('Marine') is a company that catches and processes rock lobsters and pilchards. Following approval by the Competition and Tariff Commission, Investhold acquired 100% of the outstanding ordinary share capital of Marine on 1 September 2015. The acquisition of Marine constituted a business combination in terms of IFRS 3 *Business Combinations*. In respect of the acquisition of Marine, Investhold considered the measurement period in accordance with par. 45 of IFRS 3 to have ended on 30 November 2015.

The purchase consideration payable by Investhold comprised the following:

- $70 million, settled in cash on 1 September 2015;
- $32 700 000, to be settled in cash on 31 August 2016; and
- $2 500 000, to be settled on 30 November 2016, subject to the proviso that the profit of Marine for the first 12 months after the acquisition date exceeds $14 million. The fair value of this potential payment amounted to $1 100 000 on 1 September 2015. This fair value increased to $2 million at 30 April 2016 as a result of revised assumptions that flowed from Marine's performance post acquisition.

Investhold incurred acquisition-related costs of $2 600 000 in respect of the acquisition of Marine, that were settled in cash on 1 September 2015.

Information relating to Marine as at 1 September 2015 and subsequently is as follows:

Carrying amount of assets and liabilities as recognised by Marine at 1 September 2015			
	Additional information	**Dr. $'000**	**Cr. $'000**
Fishing vessels	2.1	36 800	–
Fishing rights	2.2	4 860	–
Deferred tax liability		–	1 800
Inventories		2 660	–
Trade receivables	2.3	6 815	–
Cash and cash equivalents		5 800	–
Trade payables		–	2 000
Non-current borrowings	2.4	–	1 500
		56 935	**5 300**

Additional information

2.1 On 1 September 2015 the fishing vessels had a fair value of $50 million, an estimated remaining useful life of four years and an expected residual value of $0.

On 1 November 2015 one of the fishing vessels was damaged at sea in a storm and immediately scrapped. At that date (i.e. immediately prior to being scrapped), the vessel had a carrying amount of $4 million in the Marine separate financial statements and $6 million in the Investhold group consolidated statement of financial position. Marine received insurance proceeds of $3 million on 31 March 2016 relating to this vessel.

2.2 The fishing rights comprise those in respect of catching rock lobsters and pilchards:

	Additional information	Original cost to Marine	As at 1 September 2015		Fishing rights expire on
			Carrying amount	Fair value	
		$'000	$'000	$'000	
Rock lobsters	2.2.2	3 000	1 800	9 000	31 August 2018
Pilchards	2.2.1; 2.2.2	4 500	3 060	15 000	31 August 2021
		7 500	**4 860**	**24 000**	

2.2.1 On 1 September 2015, the Competition and Tariff Commission approved the acquisition of Marine by Investhold but found that with respect to pilchard fishing rights, the acquisition would substantially lessen competition as TFC and Marine are each other's closest competition. As a result, the Commission approved the acquisition of Marine by Investhold subject to Marine disposing of its pilchard fishing rights within three months of the acquisition date. The fishing rights were accordingly sold on 15 October 2015 to an unrelated party for net proceeds of $14 400 000 (proceeds of $15 million less costs to sell of $600 000).

2.2.2 No wear and tear allowances are granted on the cost of the fishing rights for tax purposes.

2.3 Marine sells rock lobsters to TFC under a supply contract that still had three years remaining on 1 September 2015. On 30 November 2015, the acquisition date fair value of the supply contract was finalised and determined to be $4 million. This was after adjusting for $1 500 000 that arose because the pricing was unfavourable to Marine, compared to market conditions on 1 September 2015. The contract has no stated termination penalty provisions.

Sales of rock lobsters from Marine to TFC during the eight months from 1 September 2015 to 30 April 2016 amounted to $28 million at a cost to Marine of $25 million. At 30 April 2016 TFC had inventories on hand acquired from Marine of $300 000 ($0 at 1 September 2015). At 30 April 2016 TFC owed $650 000 to Marine (31 August 2015: TFC owed $200 000 to Marine).

2.4 The non-current borrowings reflect the capital outstanding (and face value) in respect of a zero interest loan that Marine negotiated with one of its previous shareholders on 1 December 2012. The $1 500 000 is repayable in full on 30 April 2018.

2.5 Marine leases premises for its head office, cold storage and processing functions under an operating leasing arrangement from an unrelated party that had five years remaining on 1 September 2015. At that date the discounted future cash flows that Marine had to pay under the leasing arrangement amounted to $10 million. This was $2 million less than the fair value of the lease at current market terms. The leasing arrangement has no stated termination penalty provisions.

2.6 On 1 May 2012 Marine granted 500 000 equity-settled share options to its employees. These options, which vested on 30 April 2015, are exercisable after 1 May 2016, but before 1 December 2017. The options allow employees to acquire ordinary Marine shares for no consideration.

Investhold was not required to and did not replace the share options under this scheme when it acquired Marine. Notwithstanding this acquisition, the share scheme did not expire on 1 September 2015. Investhold has agreed that Marine would issue additional shares to the option holders as and when the share options are exercised in accordance with the original share-based payment arrangement.

Each Marine share option had the following fair values at the respective dates:

Date	**Fair value of each Marine option**
1 May 2012	$1,90
30 April 2015	$2,50
1 September 2015	$2,85

2.7 Marine earned a profit of $10 200 000 during the eight-month period ended 30 April 2016 and declared and paid an ordinary dividend of $1 million on 31 March 2016.

3 Investments in associates

Information on the Investhold group's carrying amount in respect of its investments in associates is as follows:

	Investments in associates
	$'000
Carrying amount at 1 May 2015	96 800
Additions, settled in cash	15 000
Share of profit of associates	7 614
Share of other comprehensive income of associates	2 166
Dividends received	(4 000)
Carrying amount at 30 April 2016	117 580

4 Investhold

The following information relates to Investhold (the company):

4.1 Investhold earned profit for the financial year ended 30 April 2016 of $28 million. The company's policy is to declare only one dividend annually. In line with this, Investhold declared an ordinary dividend of $20 million on 27 February 2016. No dividends were unpaid at 30 April 2016 (30 April 2015: $0).

4.2 Investhold revalued its land and buildings upwards by $20 million on 30 April 2016. This is in accordance with the group accounting policy to periodically revalue owner-occupied land and buildings to fair value.

4.3 On 1 April 2014 Investhold's remuneration committee granted 2 500 000 equity-settled share options to each of its four executive directors, subject to approval by Investhold's shareholders, which was obtained on 1 May 2014.

- The share options entitle the directors who are still employed by Investhold (or an entity within the group) on 30 April 2018 to acquire ordinary shares in

Investhold on or after 30 April 2018 at a 25% discount to the weighted average share price for the five days prior to the exercise date.

- At 30 April 2016 Investhold expected that 75% of the share options would vest on 30 April 2018. At 30 April 2015 Investhold expected that all the share options would vest.

- The fair value of each Investhold share option at the relevant dates is as follows:

Date	**Fair value of each Investhold option**
1 April 2014	$5,90
1 May 2014	$6,00
30 April 2015	$7,50
30 April 2016	$8,25

5 Other information

- Investhold and Marine were able to borrow at a market-related effective rate of 9% per annum during all periods presented.

- There were no disposals of any subsidiaries during FY2016.

- Cash flows from operating activities are reported using the indirect method as allowed by IAS 7 *Statement of Cash Flows*.

- Cash flows relating to dividends and interest are reported as cash flows from operating activities.

Appendix A: Draft consolidated statement of profit or loss and other comprehensive income of the Investhold group

Investhold Draft consolidated statement of profit or loss and other comprehensive income for the financial year ended 30 April 2016			
	Notes	**2016** **$'000**	**2015** **$'000**
Revenue		1 056 500	885 000
Cost of sales		(559 600)	(496 000)
Gross profit		496 900	389 000
Marketing, distribution and selling expenses		(108 800)	(98 150)
Administration expenses		(178 700)	(146 000)
Operating profit	1	209 400	144 850
Interest income		2 760	2 090
Dividend income		3 716	1 500
Finance costs	2	(5 817)	(2 540)
Share of profit of associates		7 614	9 800
Profit before taxation		217 673	155 700
Income tax expense		(54 418)	(35 811)
Profit for the year		163 255	119 889
Other comprehensive income			
Items that will not be reclassified to profit or loss:			
Re-measurement gains on investments		8 000	6 500
Revaluation gains on land and buildings		42 700	12 000
Share of other comprehensive income of associates		2 166	1 008
Income tax relating to items that will not be reclassified		(13 444)	(4 569)
Other comprehensive income, net of taxation		39 422	14 939
Total comprehensive income for the year		202 677	134 828
Profit for the year attributable to:			
Owners of Investhold		160 615	113 895
Non-controlling interest		2 640	5 994
		163 255	119 889
Total comprehensive income for the year attributable to:			
Owners of Investhold		200 037	126 593
Non-controlling interest		2 640	8 235
		202 677	134 828

Notes

1 Operating profit (cost of sales) includes the following:

	2016	**2015**
	$'000	**$'000**
Depreciation of property, plant and equipment	48 700	31 090
Amortisation of intangible assets	22 500	12 180

2 Finance costs relate only to financial liabilities measured at amortised cost.

Appendix B: Assets and liabilities sections extracted from the draft consolidated statement of financial position of the Investhold group

Investhold
Extract from the draft consolidated statement of financial position as at 30 April 2016

	Notes	2016	2015
		$'000	**$'000**
Assets			
Property, plant and equipment		612 000	419 500
Goodwill, net of impairments		38 000	35 000
Intangible assets (cost model)		138 000	98 800
Investments in associates		117 580	96 800
Other investments		90 000	76 000
Inventories		209 100	190 250
Trade receivables		216 080	259 666
Cash and cash equivalents		261 131	233 787
Total assets		**1 681 891**	**1 409 803**
Liabilities			
Deferred taxation		72 605	48 237
Non-current borrowings		35 000	8 100
Trade payables and accrued expenses		318 000	308 900
Amounts owing to sellers of Marine shares		33 800	–
Current income tax payable		14 009	20 765
Bank overdrafts	1	138 700	98 751
Total liabilities		**612 114**	**484 753**

Notes

1 Investhold's bank overdrafts are repayable on demand and form an integral part of its cash management.

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PROFESSIONAL PAPER 3

The required section of this question consists of two parts. Answer each part in the correct, separate answer book.

QUESTION 1 PART I – REQUIRED		**Marks** Sub-total	**Total**
(a)	Calculate the goodwill or bargain purchase gain recognised on Investhold's acquisition of Marine to be disclosed in its FY2016 consolidated financial statements. Present amounts in $'000.	20	20
(b)	Prepare the Investhold consolidated statement of cash flows for FY2016. • Start with the operating profit provided in appendix A. • Present amounts in $'000. • Comparative amounts and notes are not required.	56	
	Communication skills – presentation and layout	*1*	57
Total for part I			**77**

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The required section of this question consists of two parts. Answer each part in the correct, separate answer book.

QUESTION 1 PART II – REQUIRED			**Marks**	
			Sub-total	**Total**
(c)	(i)	Identify and explain the key business risks faced by the Investhold group that should be disclosed in the FY2016 integrated report.	14	
	(ii)	For each key business risk identified, suggest a possible measure to appropriately respond to the risk.	7	
		Communication skills – presentation and layout; clarity of expression	2	23
Total for part II				**23**
Total for the question				**100**