THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ZIMBABWE

*The Institute of Chartered Accountants of Zimbabwe*

# QUALIFYING EXAMINATION

# Part I
# Paper 1

## JANUARY 2010

**TOTAL MARKS – 200** **TIME – Five hours**

**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.

NOTE: The questions in this paper reflect currencies and comparative figures in US dollars to make a meaningful comparison of financial performance possible, with no account being taken of the mathematics of converting previous Zimbabwean dollars to US dollars.

**QUESTION 1** **60 marks**

**All amounts in the question exclude Value Added Tax (VAT).**

Better Blanket Manufacturers (Pvt) Ltd ('BBM') is a company registered in Zimbabwe and is registered for VAT. The company's financial year end is 31 December.

The company traded in US dollars with effect from 1 January 2009 and it can be assumed that the balances at 31 December 2008 have all been converted at a rate of exchange approved by the Zimbabwe Revenue Authority (ZIMRA).

BBM manufactures all types of blankets which it sells to independent retail outlets throughout Zimbabwe. It also sells blankets to Botswana to a limited extent.

BBM owns a number of shares which it holds for investment purposes.

With the exception of the factory building, the assets the company had purchased in prior years had a 'nil' income tax value at 31 December 2008.

BBM had a profit before tax of US $5 million for the year of assessment ended 31 December 2009. The company did not have an assessed loss for either income tax or capital gains purposes. The profit before tax of US $5 million at 31 December 2009 comprises the following items of income and expenditure:

| | **Notes** | **Expenditure** | **Income** |
|---|---|---|---|
| | | **US $** | **US $** |
| Sales: Blankets | 1 | | 450 000 000 |
| Cost of sales: Blankets | | 443 344 950 | |
| Dividend income | | | 28 000 |
| Depreciation of all assets | | 323 600 | |
| Impairment loss – second-hand plant | 5 | 30 000 | |
| Impairment loss on shares | 4 | 54 000 | |
| Insurance payment received | 3 | | 56 000 |
| Net gain on sale of shares | 4 | | 79 900 |
| Gain on sale of laboratory land and buildings | 2 | | 705 000 |
| Interest on loan utilised for the purchase of shares | 4 | 60 000 | |
| Lease of passenger vehicle from September 2009 | | 35 000 | |
| Loss on sale of equipment | 2 | 8 000 | |
| Loss on sale of factory land and buildings | 6 | 442 500 | |
| Donation to the Destitute Homeless Persons Fund | | 60 000 | |
| Donation to a political organisation | | 20 000 | |
| Lease premium | 6 | 84 000 | |
| Pension contributions | 7 | 326 885 | |
| Provisions | 8 | 1 000 000 | |
| Research expenditure (does not include capital expenditure) | 2 | 59 965 | |
| Rent | | 20 000 | |
| Excess of income over expenditure | | 5 000 000 | |
| | | 450 868 900 | 450 868 900 |
| | | | |

## Additional information (notes)

### *1 Sales*

| | US $ |
|---|---|
| Sale of blankets in Zimbabwe | 385 000 000 |
| Export sale of blankets | 50 000 000 |
| Sale of fuel | 10 000 000 |
| Sale of scrap | 5 000 000 |
| | 450 000 000 |
| | |

### *2 Research and development*

The company had set up its own research and development division in an attempt to discover better methods of dying the yarn used in the manufacture of its blankets. In March 2009 the company purchased a building adjacent to its factory which was to be used as a laboratory. This building cost US $500 000 and land cost a further US $10 000. The experiments were not a success. As the company was short of funds and due to unrest in the area it sold the land and buildings on 15 November 2009 for US $1 215 000, of which amount US $215 000 was allocated to the land. On 1 November 2009 the company sold the laboratory equipment for US $232 000. This had been purchased in March 2009 at a cost of US $240 000

### *3 Insurance payment*

In October 2009 a computer which had been purchased in the previous tax year for US $60 000 was destroyed by a power surge. The company received US $56 000 from an insurance company. The company had proved to ZIMRA that this asset had been purchased in the 2008 year with foreign currency

### *4 Sale of shares*

The company sold a listed market security in September 2009 for US $100 000. This share had been purchased in March 2009 at a cost of US $20 100.

In March 2009 the company borrowed funds to purchase three listed securities. The company sold one of these, which it purchased at a cost of US $20 100, in September 2009 for US $100 000.

The other two, which are dividend-yielding investments, had cost US $500 000. These two listed securities were included in the company's balance sheet at their current market value of US $446 000. The decrease in the value of this investment of US $54 000 was treated as an impairment loss.

### *5 Impairment loss on second hand plant and machinery*

Zimbabwe Blankets (Pvt) Ltd, a company which had purchased plant used in its operations at a cost of US $200 000 in March 2009, sold this plant to BBM for US $250 000 on 31 August 2009. The company brought these assets into use on 1 September 2009 and the assets were capitalised at this cost. However, an independent valuation was obtained according to which the assets were valued at US $220 000 and BBM immediately impaired the plant and machinery to this market value of US $220 000.

### 6 *Factory buildings and improvements to leasehold property*

In May 2006 BBM purchased a plot of land for the equivalent of US $500 000. It erected a factory on this land at a cost of US $1 942 500. This building was brought into use on I October 2006. This conversion value was accepted by ZIMRA. As a result of continued unrest in the vicinity of this factory, BBM also sold this land and buildings on 15 November 2009 for US $2 million, being US $300 000 for land and US $1 700 000 for the buildings.

On 1 November 2009 BBM entered into a 20-year lease agreement with Tan Queray Ltd for the lease of a factory in a trouble-free area. The lease agreement stipulated that BBM would pay a premium of US $84 000 on 1 November 2009 and a monthly rent of US $10 000 (subject to an annual escalation clause).

### 7 *Pension contributions*

The company joined a new approved pension scheme in February 2009, in terms of which contributions amounted to 6,5% of each employee's salary. Included in the amount paid were contributions by the following persons:

| | **US $** |
|---|---:|
| Managing director | 6 000 |
| Finance director | 5 000 |
| Sales director | 4 500 |
| | 15 500 |
| | |

### 8 *Provisions*

| | **US $** |
|---|---:|
| Provision for leave pay calculated on the basis of number of days leave due x monthly salary | 586 000 |
| Provision for director's fees to be voted on at the next annual general meeting | 14 000 |
| Provision for anticipated repairs to manufacturing plant | 220 000 |
| Provision for valuation fee of assets to be carried out in January 2010 | 180 000 |
| | 1 000 000 |
| | |

**REQUIRED**

| | | Marks |
|---|---|---|
| (a) | Calculate the taxable income of Better Blanket Manufacturers (Pvt) Ltd for the year ended 31 December 2009. Your calculation should start with profit before tax amounting to US $5 million. You should provide explanations for any assumptions you make. | 30 |
| (b) | Calculate any capital gains tax liability or loss. | 14 |
| (c) | On the basis of information furnished, calculate the VAT output tax for the year. You should ignore the input tax, as you do not have sufficient information to determine this. | 12 |
| **Presentation marks:** | Arrangement and layout, clarity of explanation, logical argument and language usage. | 4 |

## QUESTION 2

**75 marks**

You are a first-year trainee accountant at Auditing Dynamics Inc, a firm of Registered Auditors. You have been assigned to the audit of New Era Computers Ltd (NEC). The financial year end of NEC was 31 October 2009. On Monday, 2 November 2009, you arrived at the client's premises and were provided with the following documents by the audit senior:

**A – 100** – Audit work paper on understanding the client's business
**A – 200** – Review of media releases
**A – 300** – Systems description – procurement cycle
**A – 400** – Draft consolidated management accounts of NEC for the year ended 31 October 2009

| **NEC – Year end 31 October 2009** | **WP A – 100** |
|---|---|
| **Understanding the client's business** | **Prepared by: JJK 5 June 2009**<br>**Reviewed by: AKL 6 June 2009** |

NEC was formed ten years ago by a group of young entrepreneurs who identified a need in the market for companies to source all their information technology (IT) equipment from a single supplier that will provide them with quality products, reliable maintenance and 24 hour support. NEC enters into rental and service agreements with its clients to lease IT rental equipment (laptops, desktops, printers, etc.) to the customers and to provide services (support and maintenance) for a fixed period. These rental agreements are correctly classified as operating leases.

NEC purchases the IT rental equipment as stipulated in the agreement with the client from various local and overseas suppliers. NEC accounts for the IT rental equipment in its records upon arrival at its central warehouse in Harare. The IT rental equipment is ready for delivery to clients after it has been bar-coded.

NEC listed on the Zimbabwe Stock Exchange (ZSE) in 2003. Its performance since then has not been as expected by market analysts and investors. The company has continued to incur losses for the last three financial periods. The company has also been heavily affected by the economic downturn since September 2008 and the financial director is again expecting a loss for the 2009 financial year.

NEC concluded a transaction during the year with the intention that it would result in an increase in public sector work and related earnings. In December 2008, all the directors of NEC approved a transaction to lend funds to NEWSA (Pvt) Ltd ('NEWSA') and approved the issue of new shares to NEWSA to acquire a 25% equity interest in NEC. This was the only approval of the transaction. The new shares were issued to facilitate the 25% equity investment.

The majority of shareholders of NEWSA are employees of NEC. The shareholdings of NEWSA are as follows:

| | |
|---|---|
| Walter Ndladlu | 30% |
| Joy Naido | 15% |
| NEC Staff Trust | 55% |

The executive directors of NEWSA are Walter Ndladlu and Joy Naido. Both directors are also non-executive directors of NEC, for which they receive no remuneration from NEC.

| NEC – Year end 31 October 2009 | |
|---|---|
| Review of media releases | WP A – 200 |
| | Prepared by: OOK 16 November 2009<br>Reviewed by: AKL 17 November 2009 |

**Extract from the newspaper article published in the *Business Chronicle* on 15 November 2009**

**15 November 2009 - NEC fined US $100 million for collusion**

The Competition Commission today referred the findings of its investigation into collusion by IT equipment rental agencies to the Competition Tribunal for determination. In the same matter, the Commission referred to a consent agreement with OB One, a division of OB Technology Ltd, in which OB One admitted that they colluded with their competitors in contravention of the Competition Act. On the basis of evidence provided by OB One and the investigation of the Commission, a fine of US $100 million (based on 8% of turnover over the period of contravention) was levied on 14 October 2009 against New Era Computers Ltd (ZSE code: NEC) by the commission.

In response to the ruling, a spokesperson for NEC has indicated that the company has not agreed to pay the penalty of US $100 million. NEC is going to appeal the ruling of the Competition Commission in the Courts. Neil Young, the Financial Director of NEC, also commented on the ruling of the commission by saying that NEC believes the findings to have no substance and that they would rather spend US $100 million on legal fees proving their innocence than pay the fine to the Commission. The final report of the commission, which is yet to be released, allegedly contains damaging evidence by OB One implicating the financial director, Neil Young (a Chartered Accountant (Zimbabwe)), directly in collusion with other IT equipment rental agencies. According to the local attorney for the commission, Tebogo Ramogadi, 'some of these allegations may even provide a basis for civil claims for fraud against Mr Young by third parties'.

NEC has never disclosed the investigation by the Competition Commission in any shareholder communications or financial statements, even though this process is believed to have begun in June 2006. As a result, market analysts expect a significant decrease in the NEC share price as it factors in the cost of this 'surprise' penalty. When asked why this investigation against NEC was not disclosed by NEC previously, Neil Young responded: 'We have always seen this as a trivial matter with no basis. Why should we give any attention to it, least of all in our shareholder communications and financial statements? We certainly have never considered this a matter that requires disclosure and I have no intention of disclosing this in the 2009 accounts.'

NEC's financial woes seem to continue in an unrelated matter as Hillprop Properties Ltd today filed suit against NEC in the local magistrate's court for the non-payment of arrear property lease charges amounting to some US $2 million, going back as far as June 2009.

| NEC – Year-end 31 October 2009 | WP A – 300 |
|---|---|
| **Systems description – procurement cycle** | **Prepared by: LLM 12 November 2009**<br>**Reviewed by: AKL 13 November 2009** |

NEC carries stock of the most popular IT rental equipment and small orders are normally attended to within two weeks. Large orders take longer (one to two months), as the IT rental equipment is purchased from suppliers in Europe and the United States of America.

When IT rental equipment needs to be purchased, the procurement officer will complete an e-order form on the system and the order will be placed electronically with established suppliers, after the operations director has authorised the order. All overseas purchases are hedged for foreign currency risk on the date the order is placed with the overseas suppliers. NEC has a small treasury division, consisting of two staff members, which handles all the hedging arrangements and settlements.

IT rental equipment is normally delivered by sea. Small orders can be delivered by plane in emergencies. Deliveries by sea are placed on vessels in containers and take approximately four weeks to arrive. The ship's captain will normally count the number of containers, compare the equipment in the containers with the equipment listed on the supplier's delivery note, sign a certificate to that effect and seal the container. A copy of the certificate is then faxed to NEC. The certificate and the supplier's delivery note then accompany the shipment and are delivered with the goods and a bill of lading to NEC. NEC acts as its own clearing house.

Copies of purchase orders are filed in delivery date order, which ensures that the receiving department personnel know which deliveries to expect. On the arrival of the IT rental equipment at the central warehouse in Harare, staff in the receiving department prepare goods received notes (GRNs) on which they record the supplier, date received and the actual quantity and condition of each item received. The GRNs are pre-numbered and are also matched to purchase orders by staff in the receiving department. Differences identified between goods received and goods ordered are immediately reported to the procurement officer.

The stock controllers then update the equipment listing, which contains the details of the items ordered, serial numbers, etc. The perpetual equipment records on the system are automatically updated from the GRNs. All IT rental equipment is then bar-coded, after which it is ready for delivery to the client. Delivery of the equipment is performed by NEC Fleet (Pvt) Ltd (NEC Fleet) to clients nationwide.

Before goods are delivered, a delivery note is completed on the basis of the order from the client. The system automatically assigns bar code numbers to the products to be delivered and these are also reflected on the delivery note. The representative from NEC Fleet scans the bar codes of all the items handed to him/her for delivery and the system reflects that the IT rental equipment has been picked for delivery to the client. When the goods arrive at the client, the client's asset controller signs the delivery note after he/she has scanned the bar codes of all the products and input these scans into an Internet-based interface with NEC's perpetual equipment records. The NEC system then automatically produces an exception report of equipment handed over to NEC Fleet that was not scanned by the client's asset controller. Any differences noted on this exception report are then followed up by the asset controller.

Detailed perpetual equipment records are maintained per client of IT rental equipment, including bar code numbers. In terms of the standard rental agreement, all clients are required to appoint an asset controller, who is responsible for performing a verification of all assets on a six-monthly basis. This is done by scanning all IT rental equipment using his own personal scanner and uploading these scans through the Internet-based interface to NEC's perpetual equipment records, which will then produce an exception report of equipment delivered to the client but not scanned as part of the verification. Clients are then expected to provide the necessary explanations for any exceptions noted.

| NEC – Year end 31 October 2009 | WP A – 400 | |
|---|---|---|
| **Draft consolidated management accounts of NEC for the year ended 31 October 2009** | **Prepared by: PPD 13 November 2009**<br>**Reviewed by: AKL 14 November 2009** | |
| **CLIENT PREPARED INFORMATION** | **31 October 2009** | **31 October 2008** |
| | **US $'000** | **US $'000** |
| Operating loss after tax | 18 000 | 4 000 |
| | | |
| **Assets** | **92 000** | **80 000** |
| Consumable stock | 7 000 | 11 000 |
| Property, plant and equipment | 85 000 | 69 000 |
| | | |
| **Total shareholders' equity** | **51 500** | **69 500** |
| Share capital and reserves | 51 500 | 69 500 |
| | | |
| **Current liabilities** | **40 500** | **10 500** |
| Bank | 21 500 | 2 500 |
| Creditors | 19 000 | 8 000 |

REQUIRED

| | | Marks |
|---|---|---|
| (a) | As part of the formulation of your overall audit strategy, which sets the scope, timing and direction of the audit –<br>(i) identify and discuss those risks of material misstatement at the financial statement level that are significant in directing the engagement team's audit procedures for the 2009 audit of New Era Computers Ltd; and<br>(ii) discuss your proposed overall audit responses and actions to address these identified risks of material misstatement at the financial statement level. These responses and actions need not be discussed for each individual risk identified in item (i). Detailed audit procedures are not required. | 7<br><br>8 |
| (b) | Discuss the risks of material misstatement of the valuation and allocation assertion applicable to IT rental equipment of New Era Computers Ltd. | 7 |
| (c) | Identify the key controls that New Era Computers Ltd currently has in place to address the existence assertion applicable to IT rental equipment and explain why each of these key controls would reduce the risk of material misstatement of IT rental equipment. | 12 |
| (d) | Discuss the audit procedures that you should perform in order to reduce the risk of material misstatement of the completeness assertion of IT rental equipment to an acceptable level. | 11 |
| (e) | Prepare a memorandum to advise the audit partner on the following matters, with proper motivation:<br>(i) What impact the US $100 million penalty payable to the Competition Commission has on the annual financial statements of New Era Computers Ltd for the year ended 31 October 2009; and<br>(ii) The impact of the penalty on the audit report on the annual financial statements for the year ended 31 October 2009, only in respect of the applicability of the going concern assumption. (When presenting your answer, you are not required to draft any sections of the audit report.) | 3<br><br>7 |
| (f) | Discuss the corporate governance and professional ethics considerations that you may have as auditor of New Era Computers Ltd with regard to the manner in which the finance director has dealt with the disclosure of the Competition Commission investigation against New Era Computers Ltd, as well as with regard to allegations against him contained in the *Business Chronicle* article dated 15 November 2009. | 4 |
| (g) | Identify and discuss areas of non-compliance by New Era Computers Ltd in terms of the *Companies Act*, chapter 24:03, as amended. | 11 |
| **Presentation marks:** | Arrangement and layout, clarity of explanation, logical argument and language usage. | 5 |

## QUESTION 3 65 marks

**Amounts in the question exclude VAT, except where indicated.**

Excel Leisure Ltd ('Excel') operates four golf driving ranges, two in Harare and one each in Bulawayo and Gweru. The business strategy has been to acquire land in suitable locations and develop golf driving ranges. Excel then develops family-orientated restaurants on the driving range sites to diversify income streams. Excel has traded well over the past couple of years and is intent on listing on the Zimbabwe Stock Exchange within the next 18 months. The sole shareholder and Chief Executive Officer of Excel, Mr Adamant, is keen to list his business to enable him to sell some shares and to facilitate a share incentive scheme for company employees. The company's financial year end is 31 December.

### Golf driving range division

Driving ranges require significant space and the average size of the properties owned is 75 hectares (or 750 000 square metres). Excel owns all properties from which it operates, and generally targets sites in outlying urban areas. It is hoped that the properties owned will become more valuable in time as residential development occurs around the driving ranges.

Revenue has historically been generated from two sources at the driving ranges. First, the public pays for using golf balls (charged per bucket of 50 golf balls). Second, Excel sells beverages and snacks at the golf shops.

Excel introduced golf driving range memberships with effect from the 2009 financial year. The key benefits of becoming a member are unlimited usage of the golf driving range (as opposed to paying per bucket of golf balls hit on the range) and a 10% discount on all food and beverage purchases from the restaurant situated on the site. New members are charged a once-off entrance fee of US $750. Entrance fees are not refundable in the event of individuals ceasing to be members through voluntary resignation or failure to pay membership fees when due.

The membership period is from 1 January to 31 December each year. Annual membership fees in 2009 were US $1 200 per member (regardless of whether members join in January or later in a particular year). Membership fees are payable upfront by new members. Members renewing their memberships are required to pay fees on or before 31 January every year. The introduction of membership proved popular with the public and 5 000 memberships in total were sold at the four driving ranges during 2009.

### Restaurant division

The restaurants situated at the golf driving ranges cater for golfers and non-golfers. The décor and facilities are family orientated, and the restaurants serve a wide variety of meals. Restaurants are open seven days a week for breakfast, lunch and dinner.

Excel introduced a customer loyalty programme for non-members of the golf driving ranges in January 2009. Customers electing to join the loyalty programme are issued with loyalty cards (cards with magnetic strips containing individuals' details). Customers are encouraged to present loyalty cards to waitrons when paying for purchases at restaurants and these cards are then swiped at the point-of-sale devices. Loyalty points are captured electronically, recording amounts spent and updating the balance of loyalty points. The loyalty reward is one point for each US $10 spent at restaurants which can be redeemed for food and beverages at the restaurants (in full or partial payment of bills). Loyalty points can also be redeemed for buckets of golf balls to be hit on the driving ranges.

**Finance and administration division**

The finance and administration division is located at one of the Harare driving ranges and is responsible for all the accounting, finance, human resources and administration functions of the driving ranges and restaurants. Divisional statements of comprehensive income are prepared monthly. Statements of financial position are prepared only at the company level and not per division.

The trial balance of Excel for the year ended 31 December 2009 is set out below:

| EXCEL LEISURE LTD<br>TRIAL BALANCE AT 31 DECEMBER 2009 | | | |
|---|---|---|---|
| | Notes | Debit<br>US $'000 | Credit<br>US $'000 |
| **Driving range division** | | | |
| Entrance fees received | 1 | | 3 750 |
| Annual membership fee income | 1 | | 6 000 |
| Usage of golf balls revenue | 2 | | 7 200 |
| Sales of beverages and snacks | 2 | | 6 300 |
| Cost of sales: Beverages and snacks | | 4 200 | |
| Salaries and wages | 3 | 3 240 | |
| Maintenance of driving ranges | | 2 160 | |
| Replacement of driving range golf balls | | 800 | |
| Other expenses | 3 | 480 | |
| Depreciation: Driving range equipment | 4 | 400 | |
| Depreciation: Driving range buildings | 4 | 40 | |
| **Driving range divisional profit** | | | **11 930** |
| | | | |
| **Restaurant division** | | | |
| Sale of food and beverages | 5 | | 43 200 |
| Cost of food and beverages sold | | 19 640 | |
| Salaries and wages | 3 | 5 950 | |
| Depreciation: Restaurant equipment | 4 | 1 120 | |
| Depreciation: Restaurant buildings | 4 | 360 | |
| Linen cleaning and replacement | | 1 080 | |
| Other expenses | 3 | 720 | |
| Marketing expenses | 6 | 430 | |
| **Restaurant divisional profit** | | | **13 900** |
| | | | |
| **Finance and administration division** | | | |
| Interest income | | | 1 600 |
| Salaries and wages | 3 | 1 800 | |
| Bank charges | 7 | 1 100 | |
| Depreciation: Finance and administration office equipment | 4 | 125 | |
| Electricity | 8 | 820 | |

| EXCEL LEISURE LTD<br>TRIAL BALANCE AT 31 DECEMBER 2009 (continued) | Notes | Debit<br>US $'000 | Credit<br>US $'000 |
|---|---|---|---|
| Water | 9 | 780 | |
| Advertising | 10 | 560 | |
| Other expenses | 3 | 450 | |
| **Finance and administration divisional loss** | | **4 035** | |
| | | | |
| Share capital | | | 1 000 |
| Retained earnings - 1 January 2009 | | | 47 000 |
| Trade and other payables | | | 3 800 |
| Land, at cost | 11 | 30 000 | |
| Restaurant buildings, at cost | 4 | 18 000 | |
| Accumulated depreciation: Restaurant buildings | | | 1 440 |
| Driving range buildings, at cost | 4 | 2 000 | |
| Accumulated depreciation: Driving range buildings | | | 160 |
| Driving range equipment, at cost | 4 | 4 000 | |
| Accumulated depreciation: Driving range equipment | | | 1 600 |
| Restaurant equipment, at cost | | 8 960 | |
| Accumulated depreciation: Restaurant equipment | | | 4 480 |
| Finance and administration office equipment, at cost | | 650 | |
| Accumulated depreciation: Finance and administration office equipment | | | 350 |
| Inventories | 12 | 1 800 | |
| Other current assets | | 640 | |
| Cash and cash equivalents | | 15 575 | |
| | | **85 660** | **85 660** |

**Notes**

1 Entrance and membership fees received are recognised as revenue upon receipt. Members pay entrance fees and membership fees directly into Excel's bank account through Internet banking transfers.

2 Revenue generated by the driving ranges in respect of golf ball usage and sales of beverages and snacks is on a cash only basis.

3 Salaries, wages and other expenses are fixed in nature.

4 Excel records property, plant and equipment at cost and does not revalue assets subsequent to initial recognition. Land is not depreciated and other items of property, plant and equipment are depreciated on a straight-line basis over their expected useful lives. The carrying amounts of property, plant and equipment are equivalent to their tax bases.

5 Customers can pay by credit card or cash at the restaurants. In 2009, 60% of revenue at the restaurants was on a cash basis. Members claimed a total of US $480 000 discount at the restaurants during 2009. This discount does not include any effect of the loyalty programme

(see note 6). Restaurant revenue has been recorded net of these discounts claimed by members.

6 Marketing expenses represent the direct costs of food and beverages provided, in exchange for the redemption of loyalty points at the restaurants. Excel has not recognised any other entries in respect of loyalty points.

7 Excel pays deposit fees of 1,5% on cash banked (all cash is banked and no cash is used to pay expenses). Banks deduct 2% from all credit card payment transactions in the restaurants and settle amounts owing to Excel net of these transaction fees.

8 The restaurants are responsible for 80% of Excel's electricity consumption and the balance is attributable to the driving ranges. Local authorities charge Excel on the basis of electricity consumption and there is no fixed cost element in monthly billings.

9 The driving ranges are responsible for 90% of Excel's water consumption and the balance is consumed by the restaurant division. Water suppliers charge Excel a variable rate per kilolitre of water used.

10 Excel advertises on local radio stations and through outdoor advertising to promote the driving range facilities and its restaurants.

11 The fair value of land owned by Excel at 31 December 2009 was recently determined as US $50 million by an independent property expert.

12 US $1 500 000 of inventories are attributable to the restaurant division and US $300 000 is attributable to the driving range division.

13 Excel's liability for normal taxation in the 2009 financial year is to be calculated and accrued for following the external audit.

**Allocation of finance and administration division expenses**

The finance and administration division does not allocate expenses directly attributable to the division's activities to the driving range and restaurant divisions.

REQUIRED

## PART A - to be answered in a separate book

| | | Marks |
|---|---|---|
| (a) | Discuss, with reasons, the appropriateness of the recognition and measurement of entrance fees and membership fees adopted by Excel Leisure Ltd. Your discussion need not include any calculations. | 13 |
| (b) | Discuss, with reasons, the appropriateness of the recognition and measurement of the customer loyalty programme by Excel Leisure Ltd. Your discussion need not include any calculations. | 10 |
| **Presentation marks:** | Arrangement and layout, clarity of explanation, logical argument and language usage. | 2 |

## PART B - to be answered in a separate book

| | | |
|---|---|---|
| (c) | Identify and describe the potential advantages and disadvantages of selling the usage of the golf driving ranges through annual memberships as introduced in 2009 from the perspective of Excel Leisure Ltd. | 10 |
| (d) | Determine the contribution margins and net profits of the driving range and restaurant divisions for the year ended 31 December 2009 using the variable costing approach. Ignore interest and taxation. | 16 |
| (e) | Calculate the return on total assets ratio for the driving range division and the restaurant division for the year ended 31 December 2009. | 6 |
| (f) | Identify and discuss the arguments for and against allocating the overheads of the finance and administration division to the driving range and restaurant divisions. | 6 |
| **Presentation marks:** | Arrangement and layout, clarity of explanation, logical argument and language usage. | 2 |