CHARTERED ACCOUNTANTS ACADEMY (CAA) – ICAZ ITC BOARD COURSE

MOCK EXAMS:
FINANCIAL ACCOUNTING – PAPER 1

[100 Marks]

13:00 – 13:30	Reading time	30 minutes
13:30 – 16:00	Writing of Paper	150 minutes

INSTRUCTIONS

1) **Enter your student number on the front of the answer book.**
2) **Your name must not appear anywhere.**
3) **Use of non-programmable calculators is permissible.**
4) **Any calculations must be shown in your answer book.**
5) **Working papers must be handed in with the scripts.**
6) **Answers Must Be Written In <u>Ink Not Pencil</u>**

This is a limited open book examination (use of SAICA handbooks and relevant act is permissible)

Question 1

This question consists of two parts which are not related.

You are the IFRS 15 expert in the technical division of a well-known audit firm, Museyamwa & Co. You have received the following queries from two separate clients, Dynamic Computer Solutions (DCS) and Eggbert Ltd (Eggbert) a company listed on the Zimbabwe Stock Exchange.

PART A: Query from DCS

DCS develops and supplies computerized inventory control systems and manages customers' computer systems. In November 2015 DCS entered into a contract with Proton Hydraulic Distributors (PHD) whereby DCS would supply PHD with a licence to access inventory control software, install the software and create an interface between the inventory control software and PHD's accounting software. The installation and interface processes are performed simultaneously and will not significantly modify the inventory control software. In addition DCS will manage all of PHD's computer systems for three years. As an extra service DCS will assist the production manager to develop PHD's production processes for three years post the installation of the computer software.

Payment for the software licence, its installation and the interface is due when the installation is complete. Payment for services, management of the computer systems and production development support, will take place on a monthly basis. Typically DCS offers installation and interface services whether or not they supply a licence to use the software. DCS has only recently offered production process development support and the sales staff is still researching how best to price this service.

DCS has supplied the following schedule of the stand-alone selling prices for its products and services and the quotation submitted to PHD for the contract.

Product/service	**Stand-alone selling price $'000**
Computer software	550 000
Installing software and creating interface	60 000

Managing computer system for three years	5 400 000
Production process development fee	Not determinable

Where DCS supplies and installs computer software and creates interfaces to existing systems the regular selling price for the combined package of product and services is $ 530 000. DCS does not allow a discount on the charge for managing customers' computer systems.

Quotation No 2510

27 November 2015

DCS Systems

FBC 102

Westgate

PHD

24 Simon Mazorodze Road

Harare

	$'000
Supplying and installing inventory control software and creating interface to existing accounting system	530 000
Operating computer system and production process support Payable at $156 400 per month	5 630 400
Total	**6 160 400**

PART B: Query from Eggbert

The newly appointed accountant of Eggbert has submitted an extract of the notes supporting the financial statements for the financial year ended 31 October 2015 and a description of the transactions depicted in these notes to you for review. The extract from the notes and description of the transactions is presented below.

Eggbert Ltd **Extract from Notes to the financial statements for the year ended 31 October 2015**		
Note 11	**Provisions**	**Refurbishment costs**
		$'000
	Balance at beginning of year	1 000
	Interest	80
	Refurbishment costs incurred	-500
	Balance at end of the year	**580**
Refurbishment costs		
The provision is in respect of anticipated refurbishment costs on the fleet of taxis held in a subsidiary company Splendid Transport Solutions (Pty) Ltd which has a policy of refurbishing the interior of their taxi fleet 3 years after the date of purchase. The expected life of the taxis is 5 years. An inspection of the property, plant and equipment register showed that the cost of the taxis is written off over 5 years.		
		Contract cancellation
		$'000
	Recognised at acquisition of subsidiary	4 000
	Settled	-2 000
	Balance at end of year	**2 000**

Contract cancellation
Eggbert acquired 60% of the issued share capital in Gilbert (Pty) Ltd on 1 November 2014. Prior to the acquisition Gilbert had negotiated three year supply agreements with four of its customers to supply them with "Yalbim" a highly specialised chemical which is essential for the production of a new product which Eggbert has developed. Shortly after acquisition Eggbert cancelled these agreements between Gilbert and its customers and Eggbert agreed to pay the customers a cancellation fee of $1 000 000 each, payable over two years. An amount of $ 4 000 000 was recognised as a liability of Gilbert, in respect of these cancellation fees, as part of the at acquisition accounting.

Note 18	**Investment in 8% Dilbert Debentures**	**$’000**
	Balance at beginning of year	500
	Interest	40
	Bank (Interest received)	-40
	Balance at end of the year	**500**
8% Dilbert Debentures		
Eggbert invested in 500 convertible debentures in Dilbert at their face value of $1000 each on 1 November 2012.The debentures have a face value of $1000 each and pay a fixed coupon rate of 8% p.a. The debentures are convertible into Dilbert shares at the option of the holder at a ratio of one ordinary share for every debenture held on 31 October 2016. The market related rate for similar debentures without the conversion feature, on 1 November 2012, is 12% p.a.		

Accounts Receivable	**Total** **$’000**	**30-90 days** **$’000**	**90-180 days** **$’000**	**180 -270 days** **$’000**	**270-360 days** **$’000**
Balance at end of year	3100	1800	900	300	100
Allowance for irrecoverable amounts				-120	-60
	2920	1800	900	180	40
The age analysis depicts the actual age of the receivables. The allowance for irrecoverable amounts					

is based on the pattern of past losses of approximately 40% and 60% on amounts outstanding between 180-270 and between 270-360 days respectively. Eggbert's normal credit term is 90 days after purchase although discounts are available for early settlement of amounts owing. Eggbert does not charge interest on accounts that are settled within the normal credit term.

Question 2

Marange & Company is an internationally diversified conglomerate specializing in the manufacture and distribution of camping paraphernalia. The holding company of the group, Marange Ltd ("Marange"), is listed on the Zimbabwe Stock Exchange, and has its headquarters in the Manicaland Province. The Group, in terms of preparing its interim and annual financial statements, fully complies with International Financial Reporting Standards. The group is in the process of preparing its financial statements for the year ended 31 December 2015.

Trial Balances at 31 December 2015	**MarangeLtd ($'000)**	**Cerbone SpA (CU'000)**	**Musindo (Pty) Ltd ($'000)**
Assets			
Property, Plant & Equipment	1000	89	500
Intangible Asset	-	45	100
Investment in Cerbone	851	-	-
Inventory	250	12	180
Trade and other receivables	180	10	250
Cash and cash equivalents	2600	60	40
Total Assets	4881	216	1070
Equity			
Stated capital	3741	58	300
○ *At 1 January 2015*	*3741*	*30*	*300*
○ *Share issue during the year*	-	*28*	-
Retained Earnings (1 January 2015)	450	70	400
Profit for the year	150	29	300
Liabilities			
Deferred tax	260	12	40
Trade and other payables	280	47	30
Total equity and liabilities	4881	216	1070

Cerbone SpA

Cerbone SpA ("Cerbone") is an Italian manufacturer of a range of inflatable tents; made from the waterproof, lightweight material known as 'Sheer Fabric™'. Cerbone was incorporated in 1991, and supplies tents throughout the world via various distributors.

On 1 January 2014, Marange acquired 80% of Cerbone for a consideration of CU74 000. At that date, the equity structure of Cerbone was as follows:

- Share capital: CU30 000 (50 000 shares)
- Retained Earnings: CU40 000

Except for the intangible asset described below, all other identifiable assets and liabilities in Cerbone were recognised at fair value in the financial records of Cerbone at acquisition.

Intangible Asset

The design of 'Sheer Fabric™' was initially developed by the Research & Development team at Marange several years ago; however the right of use was sold to Cerbone on 1 January 2012 for $825 000 because at the time, Marange was specializing in the manufacture of sleeping bags and beds, and the material was too delicate for these products. The right of use of the design was for a period of ten years, with a right of renewal for an additional five years, for no additional cost. The right of use agreement requires Cerbone to pay Marange an annual fee of $10 000. At 1 January 2014, the annual fee in a similar agreement is $15 000, and the annual expected revenue that Cerbone expects to generate from the use of the license, before the annual license fee, is CU14 400.

On 30 June 2015, Cerbone authorised and issued 7000 shares, at an issue price of CU4 per share. Besides the issue of these shares, there have been no other changes to the stated capital of Cerbone since its incorporation. Marange did not participate in this share issue.

Musindo (Pty) Ltd

Musindo (Pty) Ltd ("Musindo") is a Zimbabwean manufacturer of stylised camping equipment. Musindo has a decentralised structure, comprising two divisions. Each division has its own plant and machinery, operates from different factory space, and has different staff members that are allocated specifically to each division upon their appointment to the company. In addition to the two divisions, there is also a central function that consists mainly of financing assets and liabilities. The division in Musindo that contributes approximately 75% to annual turnover is the Braai Equipment division. This division manufactures a range of braai accessories, and is branded by the company as *"Bringing the 'gees' back into outdoor camping!".* This range has been very profitable in recent years due to the durability and aesthetics of the product, and the active marketing programme launched by Musindo.

In an attempt to expand their own product range, Marange acquired all of the assets and liabilities relating to the Braai Equipment division in Musindo on 1 January 2015, for a consideration of $3 million. In order to ensure that the same quality product will be produced; Marange also offered employment to all staff working in the Braai Equipment division.

The following are the fair values of the assets and liabilities in the Braai Equipment division of Musindo at 1 January 2015:

	$'000
Assets	
Property, Plant & Equipment	1 766
Intangible asset	600
Inventory	134
Liabilities	
Deferred tax	20

Musindo correctly accounted for the sale of the assets and liabilities of the Braai Equipment division to Marange at 1 January 2015 in its financial statements for the year ended 31 December 2015. Marange, however, did not process any journal entries relating to the acquisition of assets and liabilities of the Braai Equipment division. Marange did, however, account for all revenue and expenditure relating to the Braai Equipment division, including expenditure relating to the use of the assets acquired, in its financial statements for the year ended 31 December 2015.

Subsequent to the sale of the Braai Equipment division, Musindo focused on the expansion of its other division-the Running Shoes division. The division launched a new line of low-impact running shoes that assists athletes with back and knee related injuries. The product was a huge success and will be further expanded in the following year.

Additional information

- Non-controlling interest at acquisition measured at the proportionate share of the fair value of identifiable assets and liabilities in the acquiree
- Assume there are no differences between the Italian and Zimbabwean tax regimes, except that intangible assets are deductible in Italy.
- Assume a discount rate of 10% p.a. wherever applicable
- Assume profits were evenly earned during the year wherever applicable
- No dividends were declared by any company in the Marange & Company group for the year ended 31 December 2015
- The following exchange rates are applicable:

	$/CU1
Closing rates:	
31 December 2011	11
31 December 2012	10
31 December 2013	11.5
31 December 2014	14.5
30 June 2015	13.5
31 December 2015	13
Average rates:	
1 January 2012-31 December 2012	10.5
1 January 2013-31 December 2013	10.75
1 January 2014-31 December 2014	13
1 January 2015-30 June 2015	14
30 June 2015-31 December 2015	13.75