UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING

EXAMINATION QUESTION PAPER (MAIN) MAY, 2006

DEGREE/ YEAR OF STUDY	:	B.COM V
TITLE OF PAPER	:	FINANCIAL ACCOUNTING IV
COURSE CODE	:	AC501
TIME ALLOWED	:	TWO [2] HOURS

INSTRUCTIONS

1. TOTAL NUMBER OF QUESTIONS ON THIS PAPER: FOUR [4]
2. ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS.
3. WHERE APPLICABLE ALL WORKINGS SHOULD BE SHOWN.
4. ALL CALCULATIONS ARE TO BE MADE TO THE NEAREST LILANGENI

NOTE: YOU ARE REMINDED THAT IN ASSESSING YOUR WORK, ACCOUNT WILL BE TAKEN OF ACCURACY OF THE LANGUAGE AND THE GENERAL QUALITY EXPRESSION, TOGETHER WITH THE LAYOUT AND PRESENTATION OF YOUR FINAL ANSWER.

SPECIAL REQUIREMENT: NONE

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.

QUESTION 1 (compulsory):

Brianston Ltd has held 750,000 ordinary shares in Carleton Ltd for many years. At the date of acquisition, the reserves of Carleton Ltd amounted to E800,000. On 31 March 2005 Carleton Ltd bought 840,000 ordinary shares in Debra Ltd for E1,250,000.
At 30 September 2005 the balance sheets of the three companies were:

	Brianston Ltd	Carleton Ltd	Debra Ltd
	E	E	E
Freehold land and buildings - Cost	950,000	1,375,000	300,000
Plant and equipment – cost	500,000	10,000,000	750,000
Depreciation of Plant and equipment	(280,000)	(7,500,000)	(500,000)
	1,170,000	3,875,000	550,000
Investments			
750,000 ordinary shares in Carleton Ltd	1,600,000		
840,000 shares in Debra Ltd		1,250,000	
	2,770,000	5,125,000	550,000
Stocks	50,000	2,050,000	850,500
Debtors	325,000	2,675,000	1,700,000
Cash at bank	25,500	-	16,500
	400,500	4,725,000	2,567,000
Creditors under 1 year	91,500	2,385,750	1,395,800
Proposed dividends	200,000	-	-
Bank overdraft	-	1,450,850	-
	291,500	3,836,600	1,395,800
Working capital	109,000	888,400	1,171,200
	2,879,000	6,013,400	1,721,200
Capital and reserves			
Ordinary shares of E1 each	2,000,000	1,000,000	1,200,000
10% preference shares		2,000,000	
Reserves	879,000	3,013,400	521,200
	2,879,000	6,013,400	1,721,200

1. Proposed dividends have not yet been provided for on the shares in Carleton Ltd and Debra Ltd although Brianston Ltd has included dividends of 10 cents per share as receivable from Carleton Ltd in debtors.
2. Dividends on preference shares were paid for the year and Brianston own no preference shares.
3. Profits for the year in Debra Ltd were E300,000 accruing evenly through the year.
4. The directors of Brianston Ltd consider that the assets and liabilities of Carleton Ltd are shown at fair values, but fair values for Debra Ltd for the purposes of consolidation are:

	E	E
Freehold land and buildings		500,000
Plant and equipment - Valuation	900,000	
- Depreciation (unchanged)	500,000	
		400,000
		900,000
Net book value of assets before valuation		550,000
Post acquisition reserve		350,000

5. Other assets and liabilities are considered to be at fair values in the balance sheet.
6. Included in stocks on Carleton Ltd are items purchased from Debra Ltd during he last three months of the year, on which Debra Ltd recorded a profit of E80,000.
7. On 30 September 2005 Carleton Ltd draw a cheque for E100,000 and sent it to Debra Ltd to clear the current account included in debtors. As this cheque was not received by Debra Ltd until 3 October 2005, no account was taken of it the Debra Ltd balance sheet.

Required:

a) Prepare a consolidated balance sheet as at 30 September 2005 for Brainston group of companies Ltd conforming with the Companies Acts so far as the information given will permit. **(21 Marks)**

b) Also prepare calculations of the following notes as well to support your consolidated balance sheet:

i) Computation of Goodwill. **(7 Marks)**
ii) Consolidated profit and loss account **(5 Marks)**
iii) Minority interest **(7 Marks)**

Total: 40 Marks

QUESTION 2

Tayo commenced work on three construction contracts during the financial year to 31 March 2006. The first contract with Shydron commenced on 1 July 2005 and had a total sales value of E3.6 million. It was envisaged that the contract would run for two years and that the expected costs would be E3 million. On 31 March 2006 Tayo revised its estimate of total expected costs to E3.1 million on the basis of additional rectification costs of E100,000 incurred on the contract during the current financial year. An independent surveyor has estimated at 31 March 2006 that the contract is 40% complete. Tayo has incurred costs up to 31 March 2006 of E1.5 million and has received payments on account of E1.2 million.

The second contract with Rodwin commenced on 1 October 2005 and was for a two year period. This contract was relatively small and had a total sales value of E60,000. The total expected costs were E48,000. A valuation has not yet been carried out by an independent surveyor as it was not required under the terms of the contract. The directors of the company estimated at 31 March 2006 that the contract was 30% complete. The costs incurred to date were E19,000 and the payments on account received were E21,000. A non current asset which had cost E8,000 and had been specifically purchased for the project was considered to be obsolete as at 31 March 2006. The non current asset was being depreciated on the straight line basis over the 2 year period of the contract assuming no residual value. The cost of depreciation to date was included in the amount of the costs incurred.

The third contract with Lucy commenced on 1 November 2005 and was for $1^1/_2$ years. The total sales value of the contract was E2.4 million and the total expected costs were E2 million. Payments on account already received were E1 million and total costs incurred to date were E700,000. Tayo had insisted on a large deposit from Lucy because the companies had not traded together prior to the contract. The independent surveyor estimated that at 31 March 2006 the contract was 25% complete.

The company's policy is to calculate attributable profit by applying the degree of completion to estimated total profit and they are confident that their costings are accurate. The directors and auditors are satisfied that the contracts are sufficiently complete to accrue profit.

The company also has several shorter contracts which are between 6 months and 9 months in duration. Some of these contracts fall into two accounting periods and were not completed as at 31 March 2006. The directors have decided to accrue profit earned to date on these contracts in the financial statements.

Required:

Draft the income statement and balance sheet extracts of Tayo in respect of the three construction contracts for the year ending 31 March 2006 showing the position of each contract as well as the overall position. **(30 Marks)**

Total: 30 Marks

QUESTION 3

(a) Differentiate between a finance lease and an operating lease. Discuss the characteristic of each type of lease and their accounting treatment. **(5 Marks)**

(b) Tonado Limited opted to lease a machine which if it had purchased outright for cash would have cost it E50,000. The lease rental is E13,500 per annum payable in arrears for a period of five years. Interest rate implicit in the lease agreement is 12% per annum. Determine whether this is an operating lease or finance lease using an appropriate technique and provide an explanation of your answer. **(5 marks)**

(c) Nadine Limited was considering buying a machine which if purchased outright for cash would cost E100,000 but has opted to lease it at E20,000 per annum payable in advance for a period of 5 years. The interest rate implicit in the lease agreement is 15%. Using the appropriate technique determine if this is a finance lease or an operating lease and provide an explanation of your answer. **(5 marks)**

(d) Ratio analysis is a useful tool in analysing the financial performance of a company. What are the benefits to be achieved by using ratio analysis for carrying out the analysis of a company's performance and also state the limitations that one should be aware of when using ratio analysis. **(5 marks)**

(e) When carrying out ratio analysis for investment purposes one should be sceptic about the earnings figure reported by organisations in their financial statements as they will normally have a tendency to manage their reported earnings to improve the entity's financial performance. Briefly discuss 5 fundamental ways by which organisations can manage their reported earnings and give examples where necessary to illustrate your answer. **(10marks)**

Total: 30 Marks

QUESTION 4
The following information has been extracted from the financial information of Steel Wire Limited.

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2003

	E 000	E 000
Sales revenues		490
Raw materials consumed	49	
Staff costs	37	
Depreciation	74	
Loss on disposal	4	
		164
Operating profit		326
Interest payable		(23)
Profit before taxation		303
Taxation		(87)
		216
Dividend paid		(44)
Retained profit for the year		172

Balance sheet as at 31 December

	2003 E 000	2002 E 000
Non current assets (see below)	1,145	957
Current assets		
Stock	19	16
Debtors	38	29
recovered tax	7	5
Bank	19	32
	83	82
	1,228	1,039
Capital and reserves:		
Share capital	182	152
Share premium	141	80
Revaluation reserve	170	-
Accumulated profits	581	409
	1,074	641
Non current liabilities		
Long term liabilities	70	320
Current liabilities		
Trade payables	12	17
Taxation	72	61
	84	78

	1,228	1,039

	Property E000	Plant E000	Equipment E000	Total E000
Non current assets:				
Cost or valuation				
At 31 December 2002	830	470	197	1,497
Additions	-	43	55	98
Disposals	-	(18)	-	(18)
Adjustment on revaluation	70	-	-	70
At 31 December 2003	900	495	252	1,647
Depreciation				
At 31 December 2002	(90)	(270)	(180)	(540)
Charge for the year	(10)	(56)	(8)	(74)
Disposals	-	12	-	12
Adjustment on revaluation	100	-	-	100
	-	(314)	(188)	(502)
Net book value				
At 31 December 2003	900	181	64	1,145
At 31 December 2002	740	200	17	957

REQUIRED:

a) Prepare a cash flow statement for Steel Wire Limited for the year ended 31 December 2003 in accordance with the requirements of IAS 7. **(21 marks)**

(b) It has been suggested that the management of long term profitability is more important that short term cash flow. **(4 marks)**

(c) Though the cash flow statement is useful, it still has certain limitations? Discuss three limitations of the cash statement? **(5 marks)**

Total: 30 marks

Total marks for the paper (100 marks)