# Financial Accounting 201 (FAC 611S)

**DATE:** April 6, 2019  
**DURATION:** 90 Minutes  
**MARKS:** 50

## Test 2

### Instructions
1. This test paper is made up of three questions  
2. Answer ALL questions in blue or black ink  
3. Start each question on a new page in your answer sheet & show all your workings  
4. Questions relating to this test may be raised in the initial 30 minutes after the start of the paper. Thereafter, candidates must use their initiative to deal with any perceived error or ambiguities & any assumption made by the candidate should be clearly stated.

### Requirements
None

### Examiners
A. Simasiku, Dr. J Akande, Z Stellmacher and W. Gertze

### Moderator
M. Dikuua

This paper consists of 3 pages excluding this cover page
Facebook LTD has in its property, plant and equipment a machine with a carrying amount at the end of N$900 000 at 31 December 2006. The management of Facebook LTD is of the opinion that the asset may have been impaired given the economic outlook of the business. They, however, based on the most recent approved budget of the business, the estimated future cash flows of the machine are given as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Future cash inflows/(outflows)</td>
<td>N$'000</td>
<td>N$'000</td>
<td>N$'000</td>
</tr>
<tr>
<td>Basic inflows on the machine</td>
<td>400</td>
<td>480</td>
<td>560</td>
</tr>
<tr>
<td>Machine maintenance costs</td>
<td>(80)</td>
<td>(100)</td>
<td>(120)</td>
</tr>
<tr>
<td>Allocated operating costs of the machine</td>
<td>(200)</td>
<td>(200)</td>
<td>(220)</td>
</tr>
<tr>
<td>Income tax on profit</td>
<td>(16)</td>
<td>(20)</td>
<td>(28)</td>
</tr>
<tr>
<td>Upgrade costs</td>
<td>(220)</td>
<td>(0)</td>
<td>(0)</td>
</tr>
<tr>
<td>Depreciation</td>
<td>(70)</td>
<td>(70)</td>
<td>(70)</td>
</tr>
</tbody>
</table>

The machine is expected to last for another three (3) years, and management expect to be able to sell it at the end of the useful life. Details relating to the sales proceeds are as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected selling price (incl. VAT at 15% )</td>
<td>230 000</td>
</tr>
<tr>
<td>Cost of delivery to potential buyer</td>
<td>20 000</td>
</tr>
<tr>
<td>Legal costs involved in sale agreement</td>
<td>10 000</td>
</tr>
<tr>
<td>Cost to reorganise the production layout of the factory due to disposal of asset</td>
<td>15 000</td>
</tr>
</tbody>
</table>
If Facebook LTD were to sell the asset, it will result in taxable recoupment of N$150 000 on which tax of N$45 000 will be incurred (tax rate 30%)  

Income tax rate 30%  

Present Value based on a discount rate of 15% is 0.8700 for year 1, 0.7600 for year 2, 0.6600 and for year 3, 0.5700.  

**Required**  

a. Calculate the fair value less cost to sell 6MKs  
b. Calculate the business future net cash flows for the projected remaining useful life of the asset 10MKs  
c. Calculate the value in use of the machine 5MKs  
d. What’s the recoverable amount 3MKs  
e. Determine the impairment loss on the assets if any 3MKs  
f. Journalise the impairment loss if any on the machine. 3MKs  

**Question 2: Investment property (IAS 40) (20 Marks)**  

a. Kyle Co  

On 1 January 2011 Kyle Co purchased an investment property for N$12 million and carries it in the business’s financial statement under the fair value model.  

On 1 July 2011 Kyle Co decided to move into the property and use it for its own business. At this date the asset had a fair value of N$14 million and a remaining useful life of 14 years.  

**Required:**  

a. Explain the amounts to be recorded in Kyle Co’s financial statement for the year ended 31 December 20X1? 5MKs  
b. Show the Journal entries. 5MKs  

NB; Kyle Co uses cost model for its Property plant and equipment.
b. **Addlington** purchased a property that it using as its head office at 1 January 2015 for N$20 million with a useful life 20 years. On 1 July 2015 the business was reorganised, cheaper premises were found for use as a head office. It was therefore decided to lease the property under an operating lease. The property was valued by a qualified professional, who assessed the property’s value as N$21 million on 1 July 2015 and N$21.6 million on 31 December 2015.

**Required:**

**Show the journal entries relating to the property for the year-ended 31 December 2015.**

10MKs

NB; Addlington applies cost model for its PPE and fair value model for its investment property

End of paper
Question 1: Impairment of asset (IAS 36)  

a. Fair value less cost to sell  
   Expected selling price 230√
   Less: cost to sell
   Delivery cost 20√
   Legal cost 10√
   Transaction cost \( (230 \times \frac{15}{115}) \) 30√ (60) √

Award 1 mark even if the student did not give a subtotal: the required did not specifically ask for a subtotal.

NB: income tax (45 000) and reorganisation cost (15 000) are to be excluded according to IAS 36

6Mks

b. Net cash flows from the continuing use of the machine (in thousand N$)

\[
\begin{array}{ccc}
2007 & 2008 & 2009 \\
\text{Cash inflows} & 400√ & 480√ & 560√ \\
\text{Maintenance costs} & (80) √ & (100) √ & (120) √ \\
\text{Allocated operating cost} & (200) √ & (200) √ & (220) √ \\
\text{Income tax (excluded)} & - & - & -√ \\
\text{Upgrade cost (excluded)} & - & - & -√ \\
\text{Depreciation (non-cash item, excluded)} & - & - & -√ \\
\end{array}
\]

FV less cost to sell (a) 170√ p
Net cash flows

\[
\begin{align*}
\text{Net cash flows} & \quad 120 \checkmark \quad 180 \checkmark \quad 390 \checkmark \quad \cancel{p} \\
\text{\(= 20\) ticks/2 = 10MKs}
\end{align*}
\]

c. **Value in use:** this entails present valuing the net future cash flows base on the discounting factors as follows:

\[
\begin{align*}
\text{20x7} & \quad 20x8 & \quad 20x9 \\
\text{Net cash inflows} & \quad 120 \checkmark \quad 180 \checkmark \quad 390 \checkmark \quad p \\
\text{Discounting factors} & \quad 0.87 \checkmark \quad 0.76 \checkmark \quad 0.66 \checkmark \\
\text{Present value} & \quad 104 \checkmark \quad 137 \checkmark \quad 257 \checkmark \quad p \\
\text{Therefore, the VIU = 104 + 137 + 257 = 498} \checkmark \\
\text{\(= 10\) ticks/2 restrict to 5 MKs}
\end{align*}
\]

d. **Recoverable amount in the higher of:**

\[
\begin{align*}
\text{N}\$ \\
\text{FV less cost to sell} & \quad 170 000 \checkmark \quad p \\
\text{Value in use} & \quad 498 000 \checkmark \quad p \\
\text{Hence, RA = N}\$498 000 \checkmark \quad p \\
\text{3MKs}
\end{align*}
\]

e. **Impairment loss:**

\[
\begin{align*}
\text{N}\$ \\
\text{Carrying amount} & \quad 900 000 \checkmark \\
\text{Recoverable amount} & \quad (498 000) \checkmark \quad p \\
\text{402 000} \checkmark \quad p \\
\text{3MKs}
\end{align*}
\]

f. **Journal entries**

\[
\begin{align*}
\text{Dr} & \quad \text{Cr} \\
\text{Impairment loss (P&L)} & \quad 402 000 \checkmark \quad p \\
\text{Accumulated impairment loss} & \quad 402 000 \checkmark \quad p \\
\text{Impairment of machine (900 000 – 498 000) } \checkmark \quad p \\
\text{3MKs}
\end{align*}
\]
Question 2: investment Property (IAS 40) 20 Marks

a. Kyle Co

- On the date that Kyle Co moves into the property, it should be classed as property, plant and equipment. ✓
- As Kyle Co uses the fair value model for investment properties, this should be revalued to fair value at the date of reclassification, ✓
- resulting in a fair value gain of N$2 million being recorded in the statement of profit or loss. ✓
- Following this, the asset should then be depreciated over its remaining useful life of 14 years. ✓
- Therefore, Kyle Co will also have a depreciation expense of N$500,000, being N$14m/14 years, for the last six months of the year and N$13.5 million as PPE. ✓

Journal entries

Dr Cr

No marks for narrations – marks awarded for correct account names + amounts

1 Jan 20x1

Investment properties 12m

Bank 12m

Investment property acquisition ✓

1 July 20x1

Investment property (FV increase) 2m

FV adjustment (P&L) 2m

Fair value increase on adjustment ✓

Property, plant and equipment (PPE) 14m

Investment property 14m

Reclassification of investment property ✓

31 Dec 20x1

Depreciation (P&L) 500k
PPE (Accumulated depreciation) 500k

PPE depreciation for half year. 

b. Addlington

Addlington will treat the property using IAS 16 for the first six-months of the year before applying IAS 40

<table>
<thead>
<tr>
<th>Journal entries</th>
<th>1 Jan 2015</th>
<th>30 June 2015</th>
<th>31 Dec 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property plant and equipment</td>
<td>20m</td>
<td>Depreciation (P&amp;L) ($20 million/20 years x 6/12) 0.5m</td>
<td>IP: office building FV 0.6m</td>
</tr>
<tr>
<td>Bank</td>
<td>20m</td>
<td>PPE: Office building CA 0.5m</td>
<td>FV adjustment on IP (P&amp;L) 0.6m</td>
</tr>
<tr>
<td>Purchase of owner-occupied property</td>
<td></td>
<td>Depreciation to date of change in use</td>
<td>Adjustment to FV of IP at year end.</td>
</tr>
<tr>
<td>PPE: office building CA</td>
<td>1.5m</td>
<td>Revaluation surplus 21m – (20m – 0.5m) 1.5m</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Head office building revaluation to fair value on the change in use</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>IP: office building FV 21m</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>PPE: office building carrying amount 21m</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Transfer of office building from PPE to IP</td>
<td></td>
</tr>
</tbody>
</table>