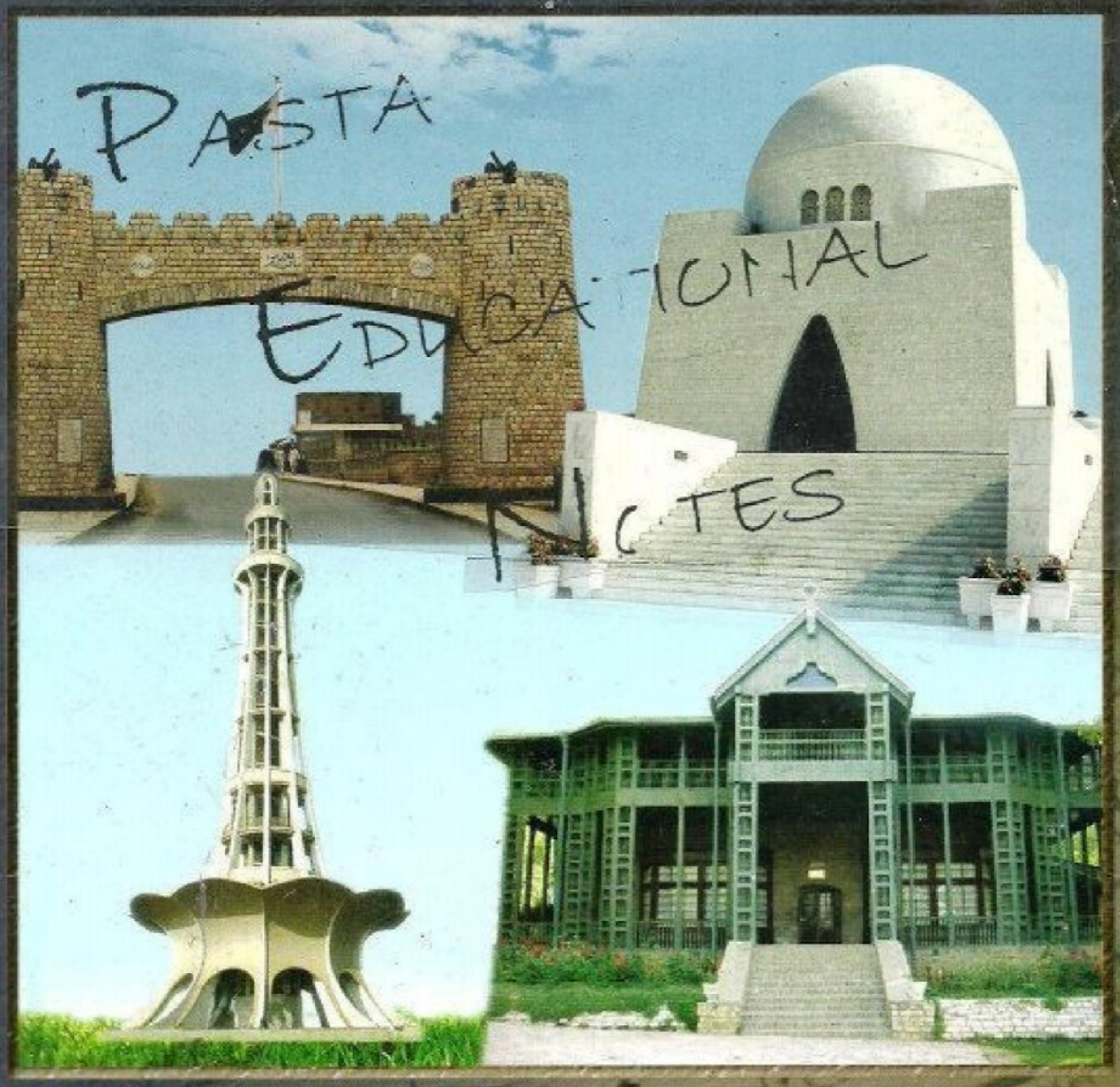

Gripping IFRS: Graded Questions

DL KOLITZ AND CL SOWDEN-SERVICE

Pakistan Edition 2009

CD containing suggested answers enclosed

The Institute of Chartered Accountants of Pakistan

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Gripping IFRS 2009

Graded Questions

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Part 1

Chapter 1
Financial reporting framework

Question		Key issues
1.1	The IASB	
1.2	Fair presentation	

Question 1.1

The International Accounting Standards Board (IASB), based in London, began operations in 2001.

Required:

a) Describe the objectives of the IASB.

b) Discuss the composition of the IASB.

c) Explain the due process for the development of International Financial Reporting Standards.

Question 1.2

"Financial statements should fairly present the financial position, financial performance and cash flows of an entity. The application of IFRSs, with additional disclosure when necessary, is presumed to result, in financial statements that achieve a fair presentation."

(IASB (2007) *IAS 1, Presentation of Financial Statements*)

Required:

Discuss the issues relating to fair presentation and compliance with International Financial Reporting Standards. Your answer should address the following:

- the requirements for fair presentation to be achieved;
- inappropriate accounting treatments;
- where management believes that departure from a requirement in a statement is necessary.

Part 1

Chapter 2
The framework

Question	Key issues
2.1	Qualitative characteristic – reliability
2.2	Fair presentation
2.3	Qualitative characteristics – measurement
2.4	Users of financial statements
2.5	Elements of the financial statements
2.6	Income received in advance
2.7	'Self – insurance', an asset or expense?
2.8	Deciding whether or not to recognize a brand name
2.9	Treatment of an employee incentive payment.
2.10	Dividends: timing and recognition
2.11	Determining if a river meets the requirements of one of the elements of financial statements and the respective recognition criteria
2.12	Accounting for purchased goods
2.13	Recognition and measurement of the costs incurred in planting and maintaining a tree plantation
2.14	Recognition and measurement of the issue and redemption of preference shares together with correcting journal entries
2.15	Treatment of asset revaluation
2.16	Advertising expenditure

Question 2.1

One of the most important characteristics that a set of financial statements should have is 'reliability'.

Required:

Explain, in terms of the Framework, how to ensure that a set of financial statements is reliable.

Question 2.2

"Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework."
(IAS 1, paragraph 13)

Required:

Discuss the implications of the above quote in the context of the relationship between the Framework and IFRS (International Financial Reporting Standards).

Question 2.3

"Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the Balance Sheet and Income Statement. This involves the selection of the particular basis of measurement…"

(The Framework, Para 99)

Required:

Discuss how effective different measurement models are in achieving the qualitative characteristics of financial statements.

Question 2.4

"The framework is concerned with general purpose financial statements. Such financial statements are prepared and presented at least annually and are directed toward the common information needs of a wide range of users".

(Framework for the Preparation and Presentation of Financial Statements, Para 6).

Required:

a) To list the users of financial statements identified by The Accounting Framework and briefly discuss their needs for information.

b) To briefly discuss the relationship between the information needs of investors and of other users.

Question 2.5

A company issued 100 000 ordinary shares (with a par value of C1) at an issue price of C1.20 each during the year. The following is the journal entry passed by the accountant:

	Dr	*Cr*
Bank	120 000	
Share capital		100 000
Share premium		20 000

Required:

State what element the credit entries represents. Discuss, by way of a process of elimination, the reason for your answer. A discussion of the relevant definitions provided in The Framework is required.

Question 2.6

Hazyview Mall Ltd is a shopping center situated in Umzinto, Kwa-Zulu Natal. The company is in the process of preparing the financial statements for the year ended 31 December 20X3.

Whilst preparing the annual rental reconciliation the accountant found that the bookkeeper had recognised all rentals received as income, including an amount of C65 000, received in December 20X3, from a long-standing tenant in respect of his January 20X4 rental.

Required:

Explain, with reference to the relevant definitions and recognition criteria provided in the Framework, whether or not the treatment of the rental received for January 20X4 as 'income' in the financial statements of Hazyview Mall Ltd for the year ended 31 December 20X3 is correct. Where considered appropriate, the correct alternative treatment and *correcting* journal entry should be provided.

Question 2.7

Innerstrength Limited is one of your audit clients. During the audit of Innerstrength you came across the following journal entry:

	Dr	*Cr*
Insurance expense	480 000	
Insurance loss liability		480 000

On requesting the accountant to provide supporting invoices from the insurance company, the accountant explained that the director is of the belief that insurance is the biggest con in society these days. Over the years that he has paid insurance, his insurance claims have equated to roughly 20% of his premiums. As a result, Innerstrength decided to self-insure from the beginning of the year: Innerstrength intends to bear all possible future losses through its own reserves. Instead of paying an insurance company C40 000 per month, the above journal has been posted instead.

Required:

Discuss the acceptability of the above journal entry in terms of The Framework.

Question 2.8

In an effort to increase lagging sales, BGD Limited decided to sell under a new brand name. The company spent C1 500 000 on purchasing a new brand name. Sales have almost doubled and according to the directors this is ascribed solely to the new brand name. Accordingly, the C1 500 000 has been capitalised as an asset.

Required:

Discuss the treatment of the C1 500 000 with reference to The Framework.

Question 2.9

An international sports and leisure club has recently entered the South African market. The club pays large incentives to sales representatives to sign up customers on a two-year contract. The member then has to pay the club a monthly fee for the 2-year period.

The company believes that it should capitalise the incentives paid and amortise them over a 10-year period. This amortisation is based on their experience in Europe where customers who join on the two-year contract generally remain loyal members of the club after the first contract has expired. The expectation that members generally renew their contract after the expiry of the first contract is based on research performed over the last 5 years.

Required:

Discuss the treatment of the incentive payment with reference to The Framework.

Question 2.10

Independent Limited declared a final dividend of C0.15 per ordinary share on 13 April 20X4 in respect of the financial year ended 31 March 20X4. The accountant, Mr Poll, has recorded the dividend as an expense on the income statement for the year ended 31 March 20X4 and a liability on the balance sheet at 31 March 20X4.

The financial statements have not yet been finalised.

***Required*:**

Analyse the treatment of the dividend declaration.

Your answer should refer to the relevant definitions provided in The Framework. You should state whether or not the accounting treatment is acceptable, providing an alternative treatment where appropriate. A discussion of the recognition criteria is not required.

Question 2.11

McDonald's Farm needs to raise a loan from the bank to buy a new irrigation plant. The balance sheet, however, shows large liabilities and too few assets according to the farmer. He tells you that the biggest asset that the farm owns does not appear in the balance sheet - the river that runs right through the centre of the farm.

Required:

Discuss how the river should be treated in the financial statements with reference to the Framework.

Question 2.12

Minutemin, a client of yours, sells photocopiers and provides photocopying services. The manufacturer supplies inventory to Minutemin on the following terms and conditions:

- Minutemin pays the manufacturer a deposit of C3 000 per photocopier upon delivery.
- The machines have a total cost of C30 000.
- The photocopiers are displayed on Minutemin's premises and used as demonstration models until sold.
- When an item is sold, the balance of the purchase price, which is determined when the deposit is paid, is paid to the manufacturer.
- Minutemin pays for the insurance of the items while on its premises.
- If the items are not sold after 3 months, they can be returned to the manufacturer. This situation has never taken place as the company keeps only one month's inventory on hand at any one time.

Required:

Discuss how the inventory of photocopiers at the year end should be accounted for in the financial statements of Minutemin, if at all.

Question 2.13

Lumber Jacks Limited is a company with a primary interest in the forestry industry. The company purchases large tracts of land and plants scores of trees on these lands. When the trees reach a certain age, they are either sold to a major paper milling company or to manufacturers of cheap furniture. The company employs the best lumber jacks in the business and also boasts the best pine wood in the country. The founder and managing director Jim Duggan, attributes the excellent quality of the wood to their sophisticated planting process and regular maintenance and weed control.

You have been approached by the company to help resolve certain accounting issues pertaining to the year ended 31 December 20X2:

- Lumber Jacks Limited bought a farm in the Mpumalanga area that is suitable for growing pine trees. They paid C1 million for the farm and immediately started to develop the land and plant young pine trees. This involved the construction of roads to the various planting

areas, dividing the farm into sections, and creating fire and wind breaks. Holes were also dug into which young trees were planted and fertilised. This was done at a cost of C100 000 per hectare.

- Once the trees were planted they had to be watered and the weeds had to be controlled. The trees also had to be pruned to ensure that they grew straight and tall. This was an ongoing operation with costs continually being incurred.

- After a period of approximately 10 years the trees will be ready for harvest and are expected to yield a return in excess of 20% per annum on the costs incurred to establish them.

- During the financial year ended 31 December 20X2, Lumber Jacks Limited developed 10 hectares at a total cost of C1 million and also spent C300 000 on watering and maintaining the trees.

- The accountant reflected the cost of C1.3 million as an expense in the income statement. The financial director, however feels that there are enough reasons to justify the capitalisation of the C1.3 million as an asset in the balance sheet of Lumber Jacks Limited at 31 December 20X2

Required:

Discuss the appropriate recognition of the costs incurred in planting and maintaining the plantation in the financial statements of Lumber Jacks Limited as at 31 December 20X2. Specific reference should be made to The Framework.

Question 2.14

You are the newly appointed auditor of Keeptrying Ltd, charged with the responsibility of ensuring that the equity and liabilities section of the balance sheet is fairly reflected. The following extract from the draft balance sheet and additional information relevant to the current financial year ended 31 December 20X4 has been given to you:

BALANCE SHEET AS AT 31 DECEMBER 20X4 (EXTRACTS)	**20X4**	**20X3**
	C	**C**
Issued share capital		
Ordinary share capital: C1 shares	100 000	100 000
Preference share capital: 10% cumulative, redeemable C1 shares	300 000	300 000

Additional information:

- 100 000 ordinary shares of C1 each were issued on 1 January 20X1.

- 300 000 redeemable preference shares, each with a coupon rate of 10% and a par value of C1 were issued on 1 January 20X3. These shares are compulsorily redeemable on 31 December 20X5 at a premium of C0.10 per share. The effective interest rate is 12.937%.

- The preference dividends are declared and paid on 31 December each year.

- Journal entries processed to date in respect of the preference shares are as follows:

	Dr	Cr
1 January 20X3		
Bank	300 000	
Preference shares		300 000
Issue of preference shares		
31 December 20X3		
Preference dividend	30 000	
Bank		30 000
Payment of preference dividend		
31 December 20X4		
Preference dividend	30 000	
Bank		30 000
Payment of preference dividend		

- All amounts are considered to be material.

Required:

a) Provide the following definitions (per the Framework):
   i) Liability
   ii) Equity
   iii) Expense

b) Discuss the recognition of the following transactions:

   i) The *issue* of the preference shares in terms of the *liability and equity* definitions.

   ii) The *redemption* of the preference shares (that is, the payment of C330 000 on 31 December 20X5) in terms of the *expense* definition.

c) Calculate the balance at which the preference shares should be measured in the balance sheet of Keeptrying Ltd as at *31 December 20X4*.

d) Provide the correcting journal entries where considered appropriate.

Ignore taxation.

Question 2.15

Thinkican Ltd is a company that has always measured its plant at cost less accumulated depreciation and impairment losses. The directors now wish to measure the plant at fair value less subsequent accumulated depreciation and impairment losses. Revaluing plant to fair value will result in a substantial increase in its carrying amount. Although the accountant knows that the increase in value is debited to plant, he is of the opinion that the increase in value should be recognised as income.

Required:

Discuss whether the accountant's proposed treatment is correct. Your answer should be based on the relevant definitions provided in the Framework.

Question 2.16

Quick Fix Ltd is a manufacturing company engaged in the production of adhesives. The company has not performed well over the past three financial years.

So as to improve on the poor past profits, the Board approved a C2 000 000 advertising promotion during the year ended 31 December 20X8 in order to generate increased sales in the future. The advertising promotion took place (and was paid for) during December 20X8.

The accountant insists on recognising the C2 000 000 payment as an asset at 31 December 20X8. His reasoning is that future sales will increase as the number of customers grow due to the advertising campaign.

Required:

Discuss whether you agree with the accountant, making reference to the Framework. Suggest an alternative treatment if you disagree.

Part 1

Chapter 3
Presentation of financial statements

Question	Key issues
3.1	Components of financial statements and the objective of a statement of comprehensive income
3.2	Profit and loss, other comprehensive income and total comprehensive income
3.3	Discussion of consistency
3.4	Items requiring separate disclosure
3.5	Classification of assets and liabilities
3.6	Refinancing of a long-term loan
3.7	Basic statement of changes in equity and share capital notes
3.8	Basic statement of comprehensive income and notes
3.9	Adjusting entries, basic statement of comprehensive income
3.10	Basic statement of comprehensive income and statement of changes in equity
3.11	Statement of comprehensive income, statement of changes in equity, accounting policies, items requiring separate disclosure
3.12	Discussion on statement of comprehensive income presentation and preparation of a statement of comprehensive income, statement of changes in equity, and notes to the financial statements
3.13	Statement of comprehensive income, notes and disclosure of borrowings

Question 3.1

IAS 1, Presentation of financial statements, sets out the requirements for a complete set of financial statements.

Required:

a) List the components of a complete set of financial statements.

b) Discuss the reasons for the introduction of a statement of comprehensive income.

Question 3.2

IAS 1, Presentation of financial statements issued in 2007, requires a statement of comprehensive income to be presented as part of a complete set of financial statements.

Required:

Define and explain the difference between the terms profit and loss, other comprehensive income and total comprehensive income.

Question 3.3

One of the general features when preparing a set of financial statements is 'consistency of presentation'.

Required:

a) Explain what 'consistency of presentation' means in relation to the presentation of financial statements.

b) Explain why it is important for an entity to retain the presentation and classification of items in the financial statements from one period to the next.

c) Detail the circumstances under which a change in the presentation of financial statements may be made.

Question 3.4

Full Stop Limited has a factory in a small Free State town. The wall of a slimes dam at a neighbouring mine broke in May 20X8, flooding the whole town, including the company's factory. The factory was submerged in two metres of mud slime that damaged all the plant and machinery. The cost of cleaning the factory and replacing the plant and machinery amounted to C7 500 000. The financial director is unsure how this should be accounted for and disclosed in the company's financial statements.

Required:

Discuss the recognition and disclosure of the loss incurred by the company in terms of International Financial Reporting Standards.

Question 3.5

"Each entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its statement of financial position except where a presentation based on liquidity provides information that is reliable and more relevant."

(IAS 1, paragraph 60)

Required:

a) List the criteria applied by IAS 1 in classifying assets as current or non-current.

b) List the criteria applied by IAS 1 in classifying liabilities as current or non-current.

c) Discuss what is meant by the operating cycle of a business.

d) State the classification of inventories that are not expected to be realised within twelve months of the financial reporting date.

e) State the classification of accounts payable that are not expected to be settled within twelve months of financial reporting date.

f) Discuss your answers to (d) and (e) above from the perspective of the users of financial statements.

Question 3.6

Kyoto Limited received a loan of C500 000 from the bank on 1 January 20X4, which is repayable on 30 December 20X8. On 30 June 20X8 the directors passed a resolution to negotiate an agreement with the bank to renew the loan for another three years. On 20 August 20X8, an agreement was signed with the bank to renew the loan for a further three years from 30 December 20X8. The directors approved the financial statements for the year ended 30 June 20X8 on 15 September 20X8. The directors distinguish between current and non-current liabilities in the company's financial statements.

Required:

Discuss how the loan should be disclosed in the financial statements of Kyoto Limited for the year ended 30 June 20X8 in accordance with IAS 1, Presentation of Financial Statements.

Question 3.7

Garmin Limited has the following capital structure at 1 January 20X1:

Authorised share capital	**C**
Ordinary shares (C1 each)	300 000
12% Preference shares (C1 each)	100 000
10% Preference shares (C1 each)	100 000
	500 000
Issued share capital	
Ordinary shares	120 000
12% Preference shares	100 000
Share premium (arising on ordinary shares)	50 000
	270 000

- The preference shares are non-redeemable.
- During the year ended 31 December 20X1 the following took place:
  - A new share issue of 80 000 ordinary shares at C1.20 each, of which the Managing Director purchased 1 500 shares.
  - A new share issue of 50 000 10% preference shares at C1.50 each
  - Share issue expenses of C5 000 incurred were set off against the share premium account
- There are no components of other comprehensive income

Required:

Disclose the above information in the statement of changes in equity and the notes to the financial statements for the year ended 31 December 20X1 in terms of International Financial Reporting Standards.

Accounting policies are not required.

Question 3.8

The following is the trial balance of Eskimo Limited at 31 December 20X8:

ESKIMO LIMITED TRIAL BALANCE AT 31 DECEMBER 20X8	
Retained earnings – 1/1/20X8	(145 000)
Non-current liabilities: Loan from AB Bank	(25 000)
Non-distributable reserves – 1/1/20X8	(20 000)
Share capital	(240 000)
Sales	(580 000)
Interest income	(12 500)
Rent income	(23 000)
Cost of sales	300 000
Interest on bank overdraft	9 500
Other expenses	250 000
Administration expenses	25 000
Distribution expenses	25 000
Investments	50 000
Trade accounts receivable	250 000
Bank	(8 000)
Current tax payable	(12 800)
Inventories	120 000
Trade accounts payable	(225 000)
Land	200 000
Equipment – cost	100 000
Equipment - accumulated depreciation	(40 000)
Taxation	1 800

Additional information:

- Dividends of C15 000 were declared on 31 December 20X8. These had not been paid as at 31 December 20X8.
- Share capital constitutes 120 000 issued ordinary shares with a par value of C2 each. 20 000 shares were issued at par on the first day of the year.
- Accumulated depreciation on equipment at 31 December 20X7 was C25 000. There have been neither purchases nor sales of equipment during the year.
- There are no components of other comprehensive income

Required:

a) Draft the statement of comprehensive income and statement of changes in equity for the financial year-ended 31 December 20X8 and statement of financial position at that date in accordance with International Financial Reporting Standards. Only the following notes are required:

- Analysis of expenses by function
- Profit before tax

b) Show how your answer would change assuming that the dividends had been proposed but had not yet been formally declared by 31 December 20X8.

Question 3.9

The following is the trial balance of Travel Bug Limited for the year ended 31 December 20X3:

TRAVEL BUG LIMITED
TRIAL BALANCE AT 31 DECEMBER 20X3

	Debit	Credit
Sales		480 000
Rent income		50 000
Dividend income		170 000
Cost of sales	105 000	
Depreciation	80 000	
Interest income		240 000
Interest expense	22 000	
Other expenses	100 000	
Tax expense	136 590	
Dividends declared: 30 June 20X3	50 000	
Retained earnings: 1 January 20X3		63 000
Property, plant and equipment	556 000	
Rent income received in advance: 1 January 20X3		5 000
Telephone expense payable: 1 January 20X3		3 000
Accounts payable		180 000
Current tax liability		136 590
Accounts receivable	528 000	
Loan from South Bank		150 000
Share capital		200 000
Share premium		20 000
Bank	120 000	
	1 697 000	1 697 000

Additional information:

- Rent income received in advance at 31 December 20X3 is C6 000.
- Telephone expense prepaid at 31 December 20X3 is C4 000. Telephone expenses are included in 'other expenses'.
- Dividends of C30 000 were declared on 31 December 20X3. These have not yet been paid.
- Depreciation is distributed as follows:
  - 60% on factory machinery; used to make inventory - all of which has been sold.
  - 30% on company cars (used by sales representatives)
  - 10% on office computers (used for administrative purposes).
- Other expenses are allocated to the entity's core functions as follows:
  - Operations: 50%
  - Distribution: 30%
  - Administration: 20%

- There are no components of other comprehensive income

Required:

a) Process all *adjusting* journal entries required to finalise the financial statements for the year ended 31 December 20X3.
Closing transfer entries are not required.
Ignore deferred tax.

b) Prepare the statement of comprehensive income for the year ended 31 December 20X3 using the function method, (showing the breakdown of the costs on the face of the statement of comprehensive income), and in accordance with International Financial Reporting Standards.

No notes are required.

No comparatives are required.

Ignore deferred tax.

Question 3.10

The following is the trial balance of ABC Limited at 28 February 20X9, before taking the additional information into account:

ABC LIMITED
TRIAL BALANCE AT 28 FEBRUARY 20X9

Retained earnings – 1/3/20X8	(100 250)
Non-current liabilities : Loan from S Windle Loan Sharks	(52 750)
Non-distributable reserves – 1/3/20X8	(2 500)
Share capital	(36 500)
Sales	(300 000)
Royalty income	(200 000)
Dividend income	(100 000)
Cost of sales	142 500
Interest expense	9 500
Salaries and wages	250 000
Depreciation	100 000
Rates	10 000
Electricity and water	25 000
Bank	3 000
Current tax payable	(118 000)
Inventories	129 000
Accounts payable	(64 000)
Electricity prepaid – 1/3/20X8	1 000
Wages payable – 1/3/20X8	(2 000)
Accounts receivable	150 000
Equipment (Carrying amount)	40 000
Vehicles (Carrying amount)	30 000
Land and buildings	80 000
Taxation	6 000

Additional information:

- Wages of C500 have been paid towards the next year's wages.
- Electricity of C2 000 is still payable at 28/2/20X9.
- Salaries and wages are split between administration, distribution and operations on a 30:20:30 basis.
- Rates must be split between administration, distribution and operations on the basis of floor area used: the administration department uses 25% of the floor area, the distribution department 15% and the operations departments the balance.
- Electricity and water may be split between the operations and administration such that the operations departments are allocated three times as much as is allocated to administration.
- Depreciation is made up of depreciation on office equipment (30%) and vehicles (70%). Operations and administration use office equipment equally. Depreciation on vehicles constitutes 20% depreciation on directors' company vehicles, (considered to be another expense) and 80% delivery vans.
- A transfer of C50 000 must still be made from retained earnings to non-distributable reserves.
- There are no components of other comprehensive income

Required:

a) Prepare the statement of comprehensive income and the statement of changes in equity for the year ended 28 February 20X9 and the statement of financial position at that date in accordance with IAS 1. Only the following notes are required:

   - Analysis of expenses by function

   Ignore comparatives

b) Assuming that you are given the following additional information, redraft the financial statements where necessary:

   The loan agreement with S Windle Loan Sharks includes a clause whereby ABC Limited undertakes to maintain its current ratio at 1.8:1 or higher. If the current ratio drops below 1.8:1, half of the balance owing becomes repayable immediately.

Question 3.11

Durham Limited is a small company listed on Karachi Stock Exchange. The trial balance of the company at 28 February 20X6 is shown below:

DURHAM LIMITED
TRIAL BALANCE AT 28 FEBRUARY 20X6

	Debit	Credit
Ordinary share capital		5 000 000
Non distributable reserve		440 000
Retained earnings		1 250 000
Dividends	100 000	
Land and buildings	8 140 000	
Equipment	500 000	
Accumulated depreciation – equipment		200 000
Long term borrowings		1 100 000
Accounts receivable	262 000	
Inventory	258 000	
Bank	131 000	
Accounts payable		141 000
Sales		10 500 000
Cost of sales	7 500 000	
Distribution expenses	520 000	
Administration expenses	480 000	
Other expenses	600 000	
Finance costs	140 000	
	18 631 000	18 631 000

The following information is relevant:

- The authorised share capital comprises 10 000 000 ordinary shares of C1 each. 1 000 000 shares were issued at par on 30 November 20X5.

- The land and buildings are used for the supply of goods and for administration purposes. The land and buildings were revalued on 28 February 20X6 to a fair value of C8 140 000. This represented an increase of C240 000 over the previous valuation.

- Flooding during the heavy summer rains have damaged the equipment. Management considered it necessary to estimate the recoverable amount of the equipment at 28 February 20X6. The fair value less costs to sell are estimated at C250 000 and the value in use is estimated at C270 000. This has not been taken into account in preparing the above trial balance. The amount is considered to be material.

- All property, plant and equipment is depreciated using the straight line method.

- Inventory with a cost of C62 000 was estimated to have a net realisable value of C50 000 at year end. This has not been taken into account in preparing the above trial balance. The amount is considered to be material.

- Distribution costs include depreciation on buildings of C112 500, depreciation on equipment of C60 000 and salaries of sales staff of C270 000.

- Administration costs include depreciation on buildings of C85 000, depreciation on equipment of C40 000 and salaries of office staff of C342 000.
- Other costs include the fee for the audit of C20 000 and audit expenses of C3 000.
- Dividends of C100 000 were declared on 18 March 20X5 in respect of the year ended 28 February 20X5. Dividends of C150 000 were declared on 15 March 20X6 in respect of the year ended 28 February 20X6.
- The standard rate of income tax is 29%. There are no permanent or temporary differences.

Required:

a) Prepare the statement of comprehensive income of Durham Limited for the year ended 28 February 20X6 in conformity with International Financial Reporting Standards.

b) Prepare the statement of changes in equity of Durham Limited for the year ended 28 February 20X6 in conformity with International Financial Reporting Standards.

c) In so far as information is available, prepare the relevant notes to the financial statements for the year ended 28 February 20X6 in conformity with International Financial Reporting Standards.

The statement of compliance note and accounting policies for the basis of preparation, property, plant and equipment and inventory are required.

The notes relating to share capital and property, plant and equipment are not required.

Question 3.12

The managing director of Sky Limited presented you with the following draft results of operations in respect of the financial year ended 30 September 20X9:

SKY LIMITED
DRAFT RESULTS OF OPERATIONS

	C 000's
Gross profit	6 700
Other income	2 150
Other expenses	(5 408)
General expenses	4 500
Depreciation	620
Auditors fees	88
Technical fees	200
Profit before taxation	3 442
Income tax expense	(741)
Profit after taxation	2 701
Dividends on ordinary shares paid 2 February 20X9	(240)
Transfer to non-distributable reserve	(900)
Retained earnings for the year	1 561
Retained earnings at 30 September 20X8	10 110
Retained earnings per statement of financial position	11 671

The following information is relevant:

- The following items are included in general expenses:-
  - An amount of C350 000 paid to the auditors in respect of consulting fees on the installation of a computerised accounting system.
  - An amount of C1 800 000 relating to inventory written off when the company's new managing director was appointed.
  - A loss of C300 000 sustained in respect of flood damage of the machinery because the company was underinsured. The insurance proceeds totalled C900 000.

- Other income includes C900 000, a surplus on the revaluation of land. The balance represents C800 000 in respect of dividends received from listed companies, C260 000 in respect of dividends received from a subsidiary company and C190 000 in respect of interest from the subsidiary company.

- The company tax rate is 50%.

- Technical fees expense comprises of C120 000 paid to Software Consultants Inc. and the technical manager's salary of C80 000.

The new managing director, wishing to make a good impression and to maximise the earnings per share of the company has made the following proposals:

- The amount paid to the auditors, the inventory write-off and the loss from flood damage (included in 'general expenses' above) should not appear in the determination of the profit before taxation but should appear as a special deduction before dividends paid.

- The surplus on the revaluation of land (included in 'other income' above) should be incorporated in the determination of profit before taxation.

Required:

a) Comment on the proposals of the managing director.

b) In so far as the information allows, prepare the statement of comprehensive income, statement of changes in equity and relevant notes of Sky Limited for the year ended 30 September 20X9, in compliance with International Financial Reporting Standards. All amounts are to be regarded as material.

c) State what other information you would require in order to present the statement of comprehensive income in compliance with IAS 1.

Accounting policies are required.

Question 3.13

Mustard Seed Limited is a small company listed on KSE. The trial balance of the company at 28 February 20X5 is shown below:

MUSTARD SEED LIMITED
TRIAL BALANCE AT 28 FEBRUARY 20X5

	Debit	Credit
Sale of goods		8 422 500
Rendering of services		140 200
Dividends received		62 800
Profit on sale of fixtures, fittings and equipment		67 000
Cost of goods sold	6 053 500	
Distribution costs	505 300	
Administration costs	436 000	
Other expenses	48 000	
Share capital		2 000 000
Retained earnings		112 000
Dividends Paid	80 000	
Fixtures, fittings and equipment	1 200 000	
Investments	750 000	
Accounts receivable	302 300	
Inventory	250 100	
Bank	1 395 200	
Borrowings		100 000
Accounts payable		115 900
	11 020 400	11 020 400

The following information is relevant:

- Distribution costs include depreciation of showroom furniture and fittings of C82 000 and salaries of sales personnel of C320 000.
- Administration costs include depreciation of office equipment of C68 000 and salaries of office personnel of C312 000.
- Other costs include the fee for the audit of C25 000 and audit expenses of C4 000.
- The share capital comprises 1 000 000 shares of C2 each. An interim dividend of eight cents per share was declared on 15 September 20X4. A final dividend of two cents per share was declared on 15 March 20X5. The financial statements were authorised for issue on 20 March 20X5.
- Inventory with a cost of C75 000 was estimated to have a net realisable value of C52 000 at year end. This has not been taken into account in preparing the above trial balance. The amount is considered to be material.
- Borrowings comprise the balance of C100 000 on a loan raised on 1 June 20X2 and is due be settled on 30 May 20X5. Interest on the loan is charged at 12% per annum, payable annually in arrears. The interest for the current year has not been paid. The existing loan facility gives the entity the discretion to refinance the loan until 30 May 20X6. The refinancing agreement was concluded on 25 February 20X5.

- There are no components of other comprehensive income.
- The standard rate of income tax is 30%. There are no permanent or temporary differences other than those apparent from the information given.

Required:

a) Prepare the statement of comprehensive income of Mustard Seed Limited for the year ended 28 February 20X5 in conformity with International Financial Reporting Standards.

b) Prepare the relevant notes to the *statement of comprehensive income* and *statement of changes in equity* for the year ended 28 February 20X5 in conformity with International Financial Reporting Standards.

c) Describe, giving reasons, how you would disclose the borrowings in the financial statements at 28 February 20X5.

Part 2

Chapter 4
Revenue

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Question	Key issues
4.1	Short questions relating to revenue recognition
4.2	Discounts, rebates and extended credit
4.3	Recognition of sales: journals
4.4	Rendering of services: discussion and journals
4.5	Sale of goods, rendering of services, interest income: discussion and revenue note disclosure
4.6	Consignment sales: discussion
4.7	Estate agents commission: discussion
4.8	Rendering of services: discussion and journals
4.9	Sale of goods on installment
4.10	Sales of goods and services on installment
4.11	Sale of goods on installment, dividend income, interest income: discussion, journals and disclosure
4.12	Prepaid vouchers: discussion
4.13	Installment sales: discussion, lay-away sales
4.14	Gym contract
4.15	Warranty sales, sales subject to conditions, option to return
4.16	Sale of goods with service plan
4.17	Sale of call cards and airtime: discussion and journals
4.18	Loyalty programs
4.19	Sales revenue: recognition discussion

QUESTION 4.1

The following situations relate to revenue recognition:

a) A company declared its final dividend on ordinary shares on 31 December in general meeting. These final dividends will be paid with in 45 days to shareholders registered on 31 December. The year-end is 31 December.

b) Value added tax received on sales made.

c) Trade discounts allowed on goods sold

d) Cash discounts allowed on goods sold for cash

e) Settlement discounts allowed on early settlement

f) Goods sold on an instalment sale basis.

g) Goods sold by a company in Ireland to a customer in New York. The customer in New York paid the full amount for the goods before the year-end, yet the goods were only delivered to him after year-end.

h) Goods sold to a customer on a lay-by (lay away) basis.

i) Goods sold on a bill-and-hold basis.

j) A customer ordered 15 000 cartons of widgets on 31 January. The customer paid for the widgets on 31 January. Manufacturing of the widgets began on 19 February and the goods were completed and ready for delivery on 22 February but were delivered on 3 March.

k) Goods sold on credit on 31 May to Mr X who went insolvent on 30 June. The year-end is 31 December.

Required:

Consider the situations above and briefly discuss, with reference to International Financial Reporting Standards, how the revenue should be recognised, if at all.

Question 4.2

Gizmo Limited manufactures and sells vehicle engines used to modify racing cars. It is company policy to grant a 5% early settlement discount if the account is settled within 30 days and a 10% discount if the transaction is paid for in cash on transaction date. The following transactions occurred during the period:

- 2 January 20X7: Mr Schumi purchased a turbo engine at a list price of C200 000. He paid in cash on transaction date.

- 1 February 20X7: Mr Frank purchased 3 engines at a list price of C100 000 each and was given a trade discount of 10%. He paid in cash on the transaction date.

- 1 April 20X7: Ms Haki, who has been buying engines from Gizmo for the last 10 years, bought an engine at a list price of C400 000 on 60 day terms. These are not considered to be extended credit terms. Ms Haki paid on 31 May 20X7.

- 1 May 20X7: Mr. Rory purchased 10 engines at a list price of C100 000 each (on 60-day terms). Mr. Rory will be selling them to a foreign racing club. In order to foster good business relations going forward, Gizmo Limited gave him a rebate of 10% to help offset his selling expenses. Mr. Rory paid on 30 June 20X7.

- 1 June 20X7: Mr. Burn purchased 10 engines at a list price of C100 000 each (on 60-day terms), less a 10% rebate. The sale agreement makes it clear that 10% rebate is against the selling price. Mr. Burn paid on 31 July 20X7.

- 1 July 20X7: Mr. Mechanic purchased 3 engines to be paid for over a period of two years. The payment plan is two instalments of C250 000 each, payable in arrears, calculated using an interest rate of 7.32125%. The cash price of the three engines is C450 000.

The 5% settlement discount is not available to customers who manage to pay within 30 days if the initial sales agreement involved either the 60-day terms or the extended credit terms.

Required

Provide the journal entry/entries required to record each of the abovementioned transactions for the period ended 31 August 20X7.

Question 4.3

Stores Limited, a retailer, entered in to the following two transactions on 10 January 20X7.

Transaction number 1: Stores Limited sold goods to a customer on the following terms:

- Quoted selling price of C160 000.
- Payment is due in 5 months time.
- Customers who purchase the goods upfront for cash, will pay only 144 535.
- Delivery has been made and the goods cost C85 000.
- Payment was received from the debtor on 10 June 20X7.

Transaction number 2: Stores Limited sold goods to a customer on the following terms:

- Quoted selling price of C150 000 was received on 10 January 20X7 with a 9-month warranty.
- This is the first time Stores Limited has entered into such a transaction with a warranty, and they therefore have no past experience to assess the probability of return.
- Stores Limited has deposited this money into their current bank account which earns 3.5% interest per annum.
- Delivery has been made and all costs are known at C76 000.

- If the item is returned, the C150 000 and the 3.5% interest earned will have to be returned to the buyer.

- The warranty expired without return of the goods on 10 October 20X7.

Required:

Prepare the journal entries to record the two transactions in its general journal for the year ended 31 December 20X7.

Question 4.4

Ralph Construction builds roads throughout the country. Ralph Construction has previously maintained and serviced all of its own earth-moving equipment through its 'Service and Maintenance Division'. This division has since been sold and in its place, Ralph Construction has contracted with Mark's Maintenance Men Limited. (a company specialising in maintenance of large machinery) to maintain all earth-moving equipment for three years.

- The contracted price for this 3-year period of maintenance is C225 000, payable immediately.

- Budgeted costs of providing this service have been drawn up by the accountant of Mark's Maintenance Men Ltd based on 10 years of previous experience:

  - Year 20X3 C30 000
  - Year 20X4 C45 000
  - Year 20X5 C75 000

Required:

a) Discuss how the income for this service contract should be recognised and measured in the financial records of Mark's Maintenance Men Ltd.
The effects of financing are considered to be immaterial in this transaction and should therefore be ignored (i.e. discounting and interest need not be discussed).

b) Show the journal entries relating to this transaction in the accounting records of Mark's Maintenance Men Ltd for each of the affected years.

Question 4.5

The Redhill Estate, an active Grape farm, is owned and run by Burnt Limited. During the current financial year Burnt Limited completed the construction of a unique "out of town" cluster development. In addition, Burnt Limited owns and operates a shop on the estate.

Clusters

The development comprises 200 cluster homes of varying shapes and sizes.

- 150 of these clusters were sold to buyers during the year, for a total of C28 500 000 (inclusive of VAT at 14%). Transfer of these units had been registered in the names of the buyers by the end of the financial year.

- Contracts had been signed for the sale of another 25 clusters, amounting to a total of C5 000 000 (excluding VAT), but at financial year end, these units had not yet been

registered in the names of the buyers. Deposits totalling C250 000 (excluding VAT) had been received to date in respect of the 25 clusters. These deposits were banked on 1 February 20X4, and earn interest at a rate of 12% per annum. 50% of the interest on deposits accrues to Burnt Limited, and the other 50% to the buyer.

Shop

Burnt Limited owns and operates a shop on Redhill Estate. The shop has daily grape-tasting, sells produce from the estate and curios from the area.

- The fees received for the grape-tasting amounted to C148 200 (inclusive of VAT).
- The produce sold from the estate amounted to C2 500 000 (excluding VAT). The shopkeeper does not earn a salary, but instead, earns commission of 10% of the selling price of the produce sold.
- The curios are carried on a consignment basis. During the year, the cost of curios delivered to the store on consignment amounted to C50 000. After the stock count, it was established that curios costing C1 500 were stolen during the year. The curios on hand at the end of the year amounted to C10 000 at cost. Curios sold to customers totalled C85 500 (inclusive of VAT).

Required:

a) Discuss the measurement and recognition criteria of IAS 18 'Revenue', specifically in relation to the transactions entered into by Burnt Limited during the year ended 31 March 20X4. Your answer must refer to all the revenue transactions, including the sale of the clusters and all the activities of the shop.

b) Prepare the revenue note in the financial statements of Burnt Limited, for the year ended 31 March 20X4, as required by International Financial Reporting Standards.

Question 4.6

Mitch Ltd is a manufacturing concern and Gareth Ltd a retailer. Mitch Ltd sells goods to Gareth Ltd on a consignment basis. The terms of the consignment sales include

- Mitch Ltd dictates the retail price at which Gareth Ltd sells the inventory; and
- Gareth Ltd pays Mitch Ltd the consignment sales price only once the goods have been sold to the public.

During 20X3, Mitch Ltd had sold goods to the value of C500 000 to Gareth Ltd of which, goods to the value of C200 000 had not yet been sold by Gareth Ltd by year-end. The accountant of Mitch Ltd stated that since no goods have ever been returned by Gareth Ltd, he intends recognising the total consignment sales during the year of C500 000.

Required:

Discuss how much revenue should be recognised in the financial statements of Mitch Ltd for the financial year-ended 31 December 20X3.

Question 4.7

Fortmann Ltd is an estate agency. The new accountant is unsure how to record the following:

- One of the estate agents, Mrs Michelle, secured an offer to purchase a property on behalf of a seller, Mr Caveman, on 28 December 20X3.
- The purchaser, Mr. Anderson, has offered to pay C200 000 for the property.
- If the seller, Mr Caveman, accepts the offer, the seller will have to pay the Fortmann estate agency C14 000 in estate agent's commission, of which C8 000 will be paid to Mrs Michelle.
- The seller accepted the offer on 29 December, but the purchaser has three months to retract his offer (called a 'cooling off period').

Required:

Discuss the recognition of the revenue from the commission on the sale of the property in the financial statements of Fortmann Estate Agency for the financial year-ended 31 December 20X3.

Question 4.8

Jillianne Ltd is a company that cleans and repairs upholstery for the hotel industry. During December 20X4, it signed a contract for the re-upholstery of all the furniture in a fifteen-storey beachfront hotel. The contract stipulated the price to be C30 000. Jillianne Ltd estimated, based on many previous re-upholstery contracts with this hotel, that the total cost to complete the project would be C18 000.

At 31 December 20X4, Jillianne Ltd had completed the re-upholstery of the furniture on the hotel's first 3 floors (at a cost of C6 000). These 3 floors are the general public areas of the hotel including the lobby, lounges, library and dining rooms and thus include most of the hotel's furniture. Since these areas are open to the general public, the furniture on these floors is also the hotel's most damaged furniture.

Required:

a) Discuss how the contract income should be recognised in Jillianne Ltd's financial statements for the year ended 31 December 20X4. Your discussion should include the relevant recognition criteria from IAS 18, Revenue.

b) Show the related journal entries for the year ended 31 December 20X4.

Question 4.9

Caravan Limited entered into a sale of ten caravans to Outdoors Limited, a retailer located in Gauteng, at a selling price of C50 000 per caravan. The normal cash selling price per caravan is C58 500 (based on cost price plus a 30% mark-up) but a trade discount of C8 500 per caravan was given since Outdoors Limited is a regular customer and generally buys in bulk.

The sale agreement was signed on 1 March 20X5, and the caravans were transported by truck to Gauteng on the same day. The transport costs and related transport insurance are to be paid for by Outdoors Limited.

The sale agreement involves instalments (based on interest of 15% per annum) as follows:

- 1 March 20X5 – C100 000 (received on 1 March 20X5)
- 28 February 20X6 – C200 000
- 28 February 20X7 – C299 000

Caravan Limited uses a perpetual inventory system.

Required:

a) Discuss how the revenue from this sale agreement should be recognised and measured in the financial statements of Caravan Limited. Calculations should be provided wherever possible.

Definitions are not required.

Prepare all related journal entries in the general journal of Caravan Limited for the year ended 31 December 20X5 and 31 December 20X6. *Ignore tax.*

Question 4.10

DS Motors is a company that retails a high end sports car called the BZ3. As all the customers of DS Motors are usually very wealthy people, most sales are made for cash.

The managing director of DS Motors has embarked on a campaign to entice customers to purchase the car by paying in instalments (i.e. instead of cash) as he believes that this will result in a greater profit for DS Motors.

The details of the campaign are as follows:

- Customers pay three equal instalments annually in arrears of C1 000 000.
- All services performed on the car over the 3 year period will be done free of charge. The estimated costs of servicing a BZ3 is C50 000 at the end of year 1, C100 000 at the end of year 2 and C200 000 at the end of year 3.

Ten customers purchased the BZ3 on 1 of January 20X6 under the new campaign. Each BZ3 usually retails for C2 152 817 (i.e. a cash price).

DS Motors normally provides services at a price of cost plus 20%.
A fair market interest rate is considered to be 10%.

Required:

Journalise the entries required in the books of DS Motors for the years-ended 31 December 20X6, 20X7 and 20X8, to account for the above information.

Question 4.11

Roger Ltd is a company that sells and repairs factory machinery. The following is the draft income statement for the year ended 31 December 20X3:

ROGER LTD
DRAFT STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X3

	20X3	20X2
	C	C
Sales	120 000	100 000
Services	80 000	80 000
Other income	70 000	80 000
Cost of sales	(50 000)	(60 000)
Operating costs	(60 000)	(50 000)
Profit before finance charges	160 000	150 000
Finance charges	(10 000)	(10 000)
Profit before tax	150 000	140 000
Taxation	(40 000)	(40 000)
Profit for the period	110 000	100 000
Other comprehensive income	-	-
Total comprehensive income	110 000	100 000

The above statement of comprehensive income has been drafted *before* taking the following transactions / information into account:

- On 5 October 20X3, a frequent customer ordered a new machine. The sale agreement, which was signed on the same day, included the following terms:
  - Cash price (before trade discount): C240 000
  - Trade discount offered: C40 000
  - The agreed price would be paid in 3 annual arrear instalments as follows:
    - C20 000 on 30 November 20X4,
    - C20 000 on 30 November 20X5 and
    - C240 000 on 30 November 20X6
- The customer indicated that the machine should be delivered as soon as possible. Roger Ltd ordered the machine from a foreign supplier on 6 October 20X3. The machine arrived – and was available for delivery – on 1 November 20X3. Due to inefficiencies within Roger Ltd's ordering system, the machine was only delivered to the customer's premises on 30 November 20X3. The customer duly signed the delivery note on this date. Roger Ltd has the policy of insuring all inventory from the date of shipment from the foreign supplier (9 October 20X3) to the date on which the inventory is successfully delivered to the customer (30 November 20X3).

- The costs incurred by Roger Ltd in acquiring the machine are analysed as follows:

	Cost incurred in:	Local currency
Total cost (paid to the supplier on 15 December 20X3)		180 000
Cost of purchase converted into the relevant local currency	20X3	150 000
Cost of shipment from the foreign supplier to Roger Ltd's premises	20X3	20 000
Cost of shipment and insurance from the premises of Roger Ltd to the local customer	20X3	10 000

- The effective interest rate is 12.937%.

- The tax expense has not yet been adjusted for the abovementioned transaction. The corporate normal income tax rate is 30% (20X2: 30%). The income from the above transaction is taxable when recognised as earned in the accounting records and the related costs are deductible when recognised as incurred in the accounting records.

- There are no components of other comprehensive income.

- Other relevant information:

	20X3 C	20X2 C
• Other income includes the following:	70 000	80 000
Dividend income	60 000	60 000
Profit on sale of land	10 000	20 000
• Finance charges includes the following:	(10 000)	(10 000)
Finance charges earned	90 000	100 000
Finance charges incurred	(100 000)	(110 000)

Required:

a) Discuss the recognition and measurement of revenue from the abovementioned transaction in the financial statements dated 31 December 20X3 and 31 December 20X4. Refer to the relevant recognition criteria and principles provided in IAS 18.

b) Where possible, provide the journal entries that would be required in 20X3 and 20X4.

c) Prepare the statement of comprehensive income (using the function method) in accordance with International Financial Reporting Standards for the year ended 31 December 20X3.

Comparatives are not required.

Accounting policies are not required.

Question 4.12

During 20X3, a large retail store issued C30 000 as prepaid vouchers for cash. The holders of these vouchers may redeem the vouchers for merchandise in future. Of these vouchers, C2 000 remain outstanding (not yet exchanged for merchandise) at year-end.

Required:

a) Discuss how the revenue from the sale of prepaid vouchers should be recognised assuming that there is no expiry date.

b) Briefly discuss how the revenue from the sale of the prepaid vouchers should be recognised assuming that the vouchers have an expiry date.

Question 4.13

Part A

Battleship Gallactica Limited sold goods under an instalment sales contract. The instalments were C1 000 per month for five months with interest charged at 12%per annum. The buyer took possession of the goods on the date of purchase.

Required:

Discuss how the revenue from this sale transaction should be recognised in the financial statements of Battleship Gallactica Limited.

No calculations are necessary.

Part B

Battleship Gallactica Limited sold goods on a lay away basis. The instalments were C1 000 per month for five months. The buyer is only entitled to take possession of the goods once the final instalment has been paid.

Required:

Discuss how the revenue this sale transaction should be recognised in the financial statements of Battleship Gallactica Limited. *No calculations are necessary.*

Question 4.14

Sporty Limited is a gym which opened approximately eleven months ago. The gym sells contracts to its customers which includes the following terms:

- The user must pay an upfront payment of C3 420 (including VAT of 14%);
- The purchaser has unlimited access to the gym for the contract period of three years.

The gym's directors are trying to make a decision on how the revenue should be recognised over the three year period. According to the research in the gym industry the services provided to the clients is concentrated mainly in the first year, as after this time the majority of the clients contracts become dormant (i.e. the users do not access the gym more than 6 times a year).

They have gone further in their analysis and have come up with an analysis of the gym visits per client. These statistics have been analysed by experts who have agreed that they are accurate. They have found that the visits to the gym for the average user are as follows:

- Year 1 80%
- Year 2 15%
- Year 3 5%

Required:

Discuss how the directors should recognise revenue from the sale of the contract, taking into account the information above. Calculate the amount of revenue that should be recognised each year in accordance with IAS 18.

Question 4.15

Dumble Door is the financial manager of a chain of general-purpose retail stores, Warthogs Limited. He has approached you with specific revenue recognition concerns. He is aware that in terms of IAS 18, revenue should only be recognised when certain criteria have been met. Of concern to him is whether the significant risks and rewards of ownership would have passed to the buyer in the following circumstances, and therefore whether Warthogs Limited should recognise revenue considering whether the other recognition criteria have been met as well.

a) Warthogs Limited sells broomsticks at a mark up of 25% for C750. These broomsticks carry a 12 month warranty in terms of which defective broomsticks will be repaired or replaced for free. Dumble informs you that past experience indicates that 2 out of every 100 broomsticks sold needs to be repaired at an average repair cost of C100 per broomstick sold.

b) Warthogs Limited sells a highly specialised MSR air-conditioning system to other manufacturing shops in their surrounding geographical region. Sale agreements entered into stipulate that Warthogs Limited is required to install the air conditioning unit at the buyer's premises, as they employ the only MSR technician in the region. 40% of the sales price relates to the installation of the unit.

c) Warthogs Limited sold a motorised lawnmower on credit to a Dubai garden-landscaping business (based in the same region as Warthogs Limited) which anticipated being awarded a contract to maintain the gardens of the vice president's private aeroplane hanger. The sales agreement entered into stipulates that the lawnmower may be returned if the purchaser is not awarded the gardening contract.

d) In addition to selling a wide range of goods, Warthogs Limited publishes and distributes local area newspapers to shops within a 20km radius. Unsold newspapers at the end of a particular month are returned to Warthogs Limited for refund or a credit. Dumble has informed you that the demand for newspapers is fairly unpredictable.

Required:

Discuss when it will be appropriate for Warthogs to recognise revenue in each of the above circumstances:

Question 4.16

Jabulani Motors Ltd is a motor dealership selling used and new cars. From 1 October 20X5, the company started selling the new Caris 1600 model motor vehicle for C147 500, including a 5 year / 90 000km service plan. The amount charged for each service within a 5 year / 90 000 kilometre period is normally C880. Services are marked up at 33 1/3 % on the cost of labour and parts. This particular model is required to be serviced every 15 000 km in order for the guarantees on the vehicle to be valid. Jabulani Motors realise a gross profit percentage of 25% on the sale of new vehicles.

On 15 March 20X6 Mr Nick signed an offer to purchase a Caris 1600 for C147 500. Mr Nick then entered into a loan agreement with Tafcat Bank to pay for the vehicle. In terms of the loan agreement Mr Nick would pay Tafcat Bank a 20% deposit on 1 April 20X6, 36 instalments of C3 948 per month in arrears and interest would be charged at an effective rate of 12.5% p.a. The offer to purchase stated that he would take delivery of the vehicle on 1 April 20X6 when the Tafcat Bank would pay Jabulani Motors Ltd the full amount of C147 500. On 31 March 20X6 Mr Nick entered into an agreement with his insurance company InSurance Ltd to insure the vehicle for C475 per month.

Jabulani Motors Ltd have processed the following journal entry to record the sale on 1 April 20X6:

	Debit	Credit
Bank	147 500	
Vehicle sales		147 500

In August 20X6 Mr Nick brought his vehicle in for its first service.

Jabulani Motors financial year ends on 30 September and during the year 100 Caris 1600's were sold to customers. At 30 September 20X6 the following services had been performed:

- 20% of vehicles sold had been serviced for the first time only, and
- 30% of vehicles sold had been serviced twice.

All amounts are considered material.

Required:

a) Discuss how the sale of the Caris 1600 to Mr Nick, should be recognised and measured in the financial statements of Jabulani Motors Limited for the year ended 30 September 20X6 in accordance with International Financial Reporting Standards.

b) Prepare all the relevant extracts from the financial statements of Jabulani Motors Ltd in respect of the *total* sales of the Caris 1600 vehicles for the year ended 30 September 20X6 in accordance with International Financial Reporting Standards. Accounting policy notes are not required.

Ignore VAT.

Ignore the effects of discounting.

Question 4.17

You are currently engaged as a financial reporting consultant of Born 2 Speak Ltd, a cellular communications company. You are assisting in the preparation of the financial statements for the year ended 31 December 20X2.

The company was granted its cellular telephone operator license in 20X0. The company operates with the intention of bringing low cost cellular packages to a broader spectrum of clients who require a "no-frills" cellular service. The company is run by young, dynamic entrepreneurs who are mainly concerned with the short term profitability of the company. The company is also a registered VAT vendor.

Since its inception in 20X0, the company has offered standard cell-phone contracts with varying terms and tariffs aimed at different sectors of the cell phone market.

On 1 January 20X2, the company launched its *Pay as you Speak (PAYS)* scheme. A massive marketing campaign was launched which had the catchphrase "It pays to be on PAYS". Activation of a contract is carried out by the retailer using a card. There are two types of cards issued:

- *Airtime cards*: These cards are sold for C114 each and entitle the purchaser to three months access to the cellular network. The purchaser can receive calls during this three month period, but can only make calls if he has a call card.
- *Call cards*: These cards are sold for C91.20 each and entitle the user to make calls up to that value. The purchaser must however, also have an Airtime card in order to use the call card.

Management feel that this scheme will enhance their reputation in the cellular industry as a serious participant and will give them exposure to a niche market.

The PAYS cards (Airtime and Call cards) are sold to various vendors including newsagents, selected clothing retailers and service stations. The vendors then sell the cards to their customers. The vendors may not mark up the price on these cards as the price is dictated by Born 2 Speak Ltd, but they do earn a commission of C10 per card sold. An invoice is made out to the vendors in respect of cards dispatched at the date of dispatch. At the end of the month, the vendors pay Born 2 Speak Ltd for the cards sold after deducting their commission. Should vendors wish to return unsold cards, they may do so provided the card is still unused.

Details of cards *dispatched* to vendors for the 20X2 year are as follows:

	Quantity dispatched	Selling price per card (including VAT)	Total
		C	C
Airtime cards	100 000 cards	114.00	11 400 000
Call cards	60 000 cards	91.20	5 472 000

At the end of the year, the following quantity of cards were unsold by the vendors:

	Quantity unsold
Airtime cards	10 000 cards
Call cards	500 cards

An extract from the schedule of monthly sales of airtime cards (in units) for the last four months was as follows:

	Quantity sold
September	2 900 cards
October	3 333 cards
November	3 000 cards
December	6 000 cards

Research done by the entity indicates that sales tend to take place at the ***beginning*** of the month, and that the use over the three month period is approximately ***equal*** for each month.

On 31 December 20X2, a computerised check was done and it was determined that of the total of 59 500 call cards sold by the vendors, 1 000 cards had 100% of the call value available and 5 000 cards had 50% of the call value available. All other cards had a negligible value remaining.

The accountant, Peter Cyclops is of the opinion that the total amount received for the sale of the cards to the vendors should be recognised as revenue in the current year.

Required:

a) Discuss in detail, the appropriate accounting treatment for the dispatch of the cards to the vendors and the rendering of the cellular service on the PAYS scheme in the accounting records of Born to Speak Ltd. Your answer must address the timing of the revenue recognition.

You should make reference to the 'Framework for the Preparation and Presentation of Financial Statements' and IAS 18, 'Revenue'.

You may ignore the accounting treatment for the commissions paid.

Do not do any computations here.

b) Calculate the amount of revenue to be recognised by Born 2 Speak Limited for the year ended 31 December 20X2 and show by means of a journal entry how the cash received from the vendors as well as the related payment of commission would be accounted for.

Question 4.18

Naty Ltd is the primary supplier of traditional medicines to all government organisations in the country. The entity operates a customer loyalty programme. It grants customers loyalty points when they spend a specified amount on their range of traditional medicines. Programme members can redeem their points for further traditional medicines. These 'points purchases' themselves do not generate any loyalty points. The points have no expiry date and management has reliably measured the fair value of each loyalty point to be C1. One point is awarded for every C10 the customer spends. The customer takes delivery of the goods on date of purchase. No sales are on credit. The entity adopts an efficient standard costing system.

Part A

Mrs Tshabalala purchases goods amounting to C1 000. She intends to redeem all the loyalty points.

Required:

a) Discuss the initial recognition and measurement of the sale of goods to Mrs Tshabalala.

b) Prepare the journal entries relating to the sale of goods to Mrs Tshabalala.

Part B

During the year ended 31 December 20X8, Naty Ltd sells medicines for a total consideration of C1 000 000. The 20X8 management expectations were that a total of 80% of these

outstanding loyalty points would be redeemed. At the end of 20X8, 40 000 points have been redeemed by customers for goods purchased.

In the 20X9 year, management revised its expectations and now expects 90% of all points to be redeemed. Actual points redeemed in 20X9: 41 000.

Required:

c) Prepare the journal entries for the year ended 31 December 20X8 relating to the total points that have been redeemed at this stage.

d) Prepare the journal entries for the year ended 31 December 20X9 relating to the redemption of loyalty points. {Ignore any sales that were made in 20X9}

Question 4.19

Retail Therapy is a small to medium-sized department store. It sold three hand-crafted statues (cost price C12 000 each), one to each of the following three customers below. The markup on cost applied by Retail Therapy is 30%. The details pertaining to the transactions with each customer are as follows:

- Customer A:
  - This customer paid in cash on the date of delivery.
  - He negotiated a special 14-day warranty with Retail Therapy.
  - Past experience indicates that this customer never returns any goods and that the goods themselves are never faulty.

- Customer B:
  - This transaction was entered into on the last day of Retail Therapy's financial year.
  - In an attempt to meet the year-end sales target, a sales consultant not only made this sale without performing a credit-worthiness check, but made this sale knowing that the customer had a previous criminal record for fraud.
  - The customer took delivery of the goods on the last day of the financial year and agreed to pay within seven days (not extended credit terms).
  - This is the first time Retail Therapy has transacted with customer B.

- Customer C:
  - A sale was concluded in and the goods were delivered to customer C one month earlier.
  - Customer C was due to pay within 14 days (not extended credit terms) but has recently fled the country as he was named as the possible mastermind of a recent case of corporate fraud.
  - At the time of the sale it was virtually certain that customer C would pay the full amount owing, as he was a reliable and long-standing customer.

Required:

Briefly discuss, in terms of IAS 18, the accounting treatment of the above three transactions. Highlight the main concept in IAS 18 that is discussed in each case.

You are not required to discuss the definition of revenue, detailed recognition criteria or disclosure.

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Solution 4.1

a) Dividend income may be recognised by the persons holding the shares (i.e. the shareholders) on 31st December, being the date on which the right to receive the dividend is firmly established.

b) Since value-added tax is an amount received on behalf of a third party (the relevant tax authority) the economic benefit does not flow to the entity receiving it. The value-added tax should therefore be shown as a liability (a present obligation expected to result in an outflow of economic benefits).

c) According to IAS 18, revenue should be recognised at fair value of the consideration received/ receivable, where 'fair value' is calculated by deducting the amount of any trade discount given. (It is interesting to note that the same principles should be applied when purchasing goods and receiving trade discount: the cost of purchases should be recorded net of trade discount received).

d) Entities granting cash discounts to customers should reduce the amount of revenue recognised on the date of sale.

e) Settlement discounts allowed have to be estimated at the date of sale and the amount of the revenue reduced accordingly. This is consistent with the requirement of IAS 18 that revenue should be recognised at the fair value of the consideration receivable (IAS 18, paragraph 9).

f) A sale of goods on an instalment-sale basis includes a financing perspective. On completion of the necessary documentation, the customer is able to take the purchased goods into his custody. The payment for these goods occurs over a period of time and the total of the instalments add up to an amount in excess of the normal cash sale price. The reason for this excess is the financing cost that the customer is expected to pay. The revenue that may be recognised on the date of the sale is the cash sale price. The balance is recognised as interest income on a time basis, using the effective interest rate method.

g) The revenue from sale of goods should only be recognised when 'the significant risks and rewards of ownership' have been transferred from the seller to the buyer and therefore the risks and rewards are generally assumed to be transferred on delivery of the goods.

However assuming that the goods had been sent before year-end, but only arrived after year-end, whether or not the sale was made on a FOB or CIF basis would then become relevant. If the goods were transported to the buyer on a F.O.B. basis (free-on-board), as the goods are packed on board the ship, they become the property of the buyer. If the goods are shipped C.I.F. (customs, insurance and freight), the seller undertakes to ensure that the goods arrive intact. The question did not specify which method was adopted, so the assumption must be that the goods were shipped C.I.F. and that the risks and rewards are only transferred on the date of delivery. Therefore, no revenue should be recognised until after year-end.

Solution 4.1 continued…

h) In a lay-by sale (otherwise known as a lay-away sale), the goods are retained in the possession of the seller until such time as the last payment is made by the buyer It differs from an instalment sale in that there is no financing aspect included in this transaction and the customer is not legally obliged to purchase the goods. Therefore, revenue is generally recognised after the final payment is received and the relevant goods are on hand and ready to be delivered. However, if *past experience indicates* that most lay-by sales are successfully concluded, then the revenue may be recognised once a significant portion of the sales amount has been received by the seller.

i) A bill and hold sale involves a customer purchasing an item that is to be delivered or collected some time in the future. The revenue from such a sale may only be recognised when the customer has been invoiced, the goods are ready for delivery and it is probable that the delivery will take place.

j) This is a normal sale (not a bill and hold) since the delay was not requested by the customer. The sale may therefore be recognised only once the goods are delivered, (on 3rd March), being the date upon which the risks and rewards are transferred and managerial control and effective management ceases.

k) Revenue from a sale that has 'gone bad' should still be shown as revenue on the date that the sale took place, with the amount considered unrecoverable shown separately as an expense (bad debt expense).

Solution 4.2

		Debit	Credit
Mr. Schumi: Cash discount			
2 January 20X7			
Bank	*200 000 x 90%*	180 000	
Sales income			180 000
Cash sale to Schumi (less 10% cash discount)			
Mr. Frank: Trade discount and cash discount			
1 February 20X7			
Bank	*100 000 x 3 x 90% x 90%*	243 000	
Sales income			243 000
Cash sale to Frank (less 10% trade and 10% cash discount)			
Mr. Alonzi: Settlement discount			
1 March 20X7			
Accounts receivable	*Given*	150 000	
Finance income allowance	*150 000 x 5%*		7 500
Sales income	*150 000 x 95%*		142 500
Credit sale to Alonzi (less 5% early settlement discount)			
30 March 20X7			
Bank	*150 000 x 95%*	142 500	
Accounts receivable			150 000
Finance income allowance		7 500	
Receipt from Alonzi within settlement period			
Ms Haki: Sale on normal credit terms *			
1 April 20X7			
Accounts receivable	*Given*	400 000	
Sales income			400 000
Credit sale to Haki			
31 May 20X7			
Bank	*Given*	400 000	
Accounts receivable			400 000
Receipt from Haki			
Mr. Rory: Rebate against expenses *			
1 May 20X7			
Accounts receivable	*10 x 100 000 x 90%*	900 000	
Sales income	*10 x 100 000 x 100%*		1 000 000
Rebate expense	*10 x 100 000 x 10%*	100 000	
Credit sale to Rory less 10% rebate against customer selling costs			
30 June 20X7			
Bank		900 000	
Accounts receivable			900 000
Receipt from Rory			

Solution 4.2 continued …

		Debit	Credit
Mr. Burn: Rebate against selling price *			
1 June 20X7			
Accounts receivable	*10 x 100 000 x 90%*	900 000	
Sales income			900 000
Credit sale to Burn less 10% rebate against selling price			
31 July 20X7			
Bank		900 000	
Accounts receivable			900 000
Receipt from Burn			
Mr. Mechanic: Sale on extended credit term *			
1 July 20X7			
Accounts receivable		450 000	
Sales income			450 000
Sale on extended credit terms to Mechanic			
31 August 20X7			
Accounts receivable	*W1: 32 946 x 2 / 12*	5 491	
Interest income			5 491
Interest income on sale on extended credit terms to Mechanic			

W1: effective interest table	**Interest income**	**Instalment received**	**Accounts receivable balance**
Inception	7.32125%		450 000
End of year 1	32 946	(250 000)	232 946
End of year 2	17 054	(250 000)	0
	50 000	(500 000)	

Solution 4.3

Transaction number 1:		**Debit**	**Credit**
10 January 20X7			
Debtors		160 000	
Revenue: sales			144 535
Unearned finance income			15 465
Recognition of sale of goods			
Cost of sales		85 000	
Inventory			85 000
Cost of goods sold			
10 June 20X7			
Bank		160 000	
Debtors			160 000
Payment received from debtor			
Unearned finance income		15 465	
Revenue: finance income			15 465
Recognition of finance income			
Transaction number 2:			
10 January 20X7			
Bank		150 000	
Revenue received in advance NOTE 1			150 000
Recognition of revenue received in advance			
Cost of sales		76 000	
Inventory			76 000
Cost of goods sold			
10 October 20X7			
Revenue received in advance		150 000	
Revenue: sales			150 000
Recognition of sale of goods			
Bank	*150 000 x 3.5% x 9/12*	3 938	
Deferred income			3 938
Recognition of deferred interest income until conditions met			
Deferred income		3 938	
Revenue: interest income			3 938
Recognition of interest income once conditions met			

Note 1: IAS 18.17 considers that only an insignificant risk of ownership is retained if a sale is made with a warranty attached, in which case the recognition criteria would be met and the revenue would be recognized. However, the same paragraph (IAS 18.17) states that if a reliable estimate of the provision for warranty is not possible, then the revenue may not be recognized. Since the company had no experience with such warranties, a reliable estimate of the provision for warranties was not possible and therefore the revenue is not able to be recognized.

Solution 4.4

a) Discussion: recognition and measurement

Introduction

The receipt of the C225 000 represents revenue from services rendered. This revenue may only be recognised if all the criteria below are met.

Discussion: recognition of revenue

- The amount of revenue can be reliably measured:

  The amount of revenue is C225 000 being the cash value of the maintenance plan.

- It is probable that the future economic benefits will flow:

  The full C225 000 has been received in advance and therefore probability is assured.

- Stage of completion can be measured reliably:

  Although the stage of completion cannot be determined accurately, it is possible to make a reliable estimate thereof.

  There are three methods to choose from when estimating the stage of completion:
  - Costs to date method
  - Number of services method
  - Surveys method (work certified method).

  Since we do not know how many services will be required, the number of services method is not appropriate. Similarly, since we have not been provided with work certified by a surveyor (and such certification would be unlikely given the unspecified nature of the work to be performed), the surveys method would be inappropriate. We do have the costs incurred to date and the total expected costs for the contract and therefore this method would be the most appropriate. The reliability of these estimates is enhanced given that Mark's Maintenance Men has 10 year's of experience to draw on when making these estimates.

- Cost incurred and to be incurred can be reliably measured:

  Costs already incurred are reliably measured (by their very nature) and the future costs may be reliably estimated since Mark's Maintenance Men Ltd has 10 year's experience to draw on in making these estimates.

Conclusion: recognition of revenue

Revenue from the maintenance contract may be recognised on a percentage completion basis over the 3-year period of the contract.

Solution 4.4 continued …

a) Discussion: recognition and measurement continued …

Discussion: measurement of revenue

The receipt of the C225 000 met the criteria for recognition as revenue. The revenue must recognised over the three-year period of the contract based on the percentage completion. The method used to determine the percentage completion must be the costs method.

W1. Estimated stage of completion: services performed		**20X3**	**20X4**	**20X5**
Costs incurred to date (to date!)	*20X3: Given* *20X4: 30 000 + 45 000* *20X5: 75 000 + 75 000*	30 000	75 000	150 000
Total expected costs	*Given*	150 000	150 000	150 000
Percentage completion to date	*20X3: 30 000 / 150 000* *20X4: 75 000 / 150 000* *20X5: 150 000 / 150 000*	20%	50%	100%

W2. Revenue recognised based on stage of completion		**20X3**	**20X4**	**20X5**
Revenue recognised to date	*225 000 x 20%* *225 000 x 50%* *225 000 x 100%*	45 000	112 500	225 000
Less revenue recognised in prior years		(0)	(45 000)	(112 500)
Revenue to be recognised in current year		45 000	67 500	112 500

W3. Alternative calculation (instead of W1 and W2):

(costs incurred in CY + costs incurred in PYs) / total expected costs x total revenue – revenue recognised in PYs

- 20X3: (30 000 + 0) / 150 000 x 225 000 – 0 = 45 000
- 20X4: (45 000 + 30 000) / 150 000 x 225 000 – 45 000 = 67 500
- 20X5: (75 000 + 75 000) / 150 000 x 225 000 – 45 000 – 67 500 = 112 500

For your information:

Please note that, technically speaking, receiving revenue at the beginning of the transaction period (upfront) leads to the receipt of finance and therefore interest expense should be recognised. The effect of this financing was given to be immaterial and therefore this complication has been ignored.

If the cash were to have been received at the end of 20X5, this transaction would have involved revenue from services and revenue from interest.

Solution 4.4 continued …

b) Journals

	Debit	Credit
20X3 Journals		
Bank	225 000	
Revenue		45 000
Revenue received in advance		180 000
Amount received in 20X3		
Costs	XXX	
Creditor/ bank		XXX
Costs incurred in 20X3		
20X4 Journals		
Revenue received in advance	67 500	
Revenue		67 500
Revenue recognised in 20X4		
Costs	XXX	
Creditor/ bank		XXX
Costs incurred in 20X4		
20X5 Journals		
Revenue received in advance	112 500	
Revenue		112 500
Revenue recognised in 20X5		
Costs	XXX	
Creditor/ bank		XXX
Costs incurred in 20X5		

Solution 4.5

a) Discussion

Revenue: general discussion

- Revenue is defined as the gross inflow of economic benefits during the period, arising in the course of ordinary activities of an entity, that result in increases in equity, other than increases relating to equity participants.

  - Revenue includes transactions and events relating to
    - the sale of goods,(the sale of the clusters, sale of the produce and curios)
    - the rendering of services,(fees from grape tasting)
    - interest, royalties and dividends (interest on the deposits)
  - Amounts collected on behalf of third parties, such as VAT are not economic benefits that flow to the entity and do not increase equity, and are excluded from revenue
  - Therefore, the VAT on the sale of the clusters, from the grape tasting and the sale of the curios must be excluded

- Revenue should be measured at the fair value of the consideration received or receivable.

The recognition criteria are applied separately to each transaction.

Revenue from the sale of goods

Revenue from the sale of goods should be recognised when all the following conditions have been satisfied:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(c) the amount of revenue can be measured reliably;

(d) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

- *Sale of clusters to buyers*

  The 150 clusters:
  - The revenue is reliably measured at C25 000 000 (C28 500 000 X 100/114).
  - It is reasonable to assume that the cost to build each home is reliably measurable.
  - The significant risks and rewards of ownership were transferred and managerial involvement and effective control ceased when legal title was transferred.
  - Since transfer is usually only registered after payment has been effected, the flow of future economic benefits has probably already occurred (and there is no evidence to suggest that the inflow of economic benefits is not probable).

  The revenue from these sales may therefore be recognised.

Solution 4.5 continued …

a) continued …

The 25 clusters:

- The revenue is reliably measured at C5 000 000 (excluding VAT)
- It is reasonable to assume that the cost to build each home is reliably measurable.
- The significant risks and rewards of ownership have not yet been transferred and managerial involvement and effective control has not yet ceased since legal title has not yet transferred.
- Since only deposits have been received to date and since sales are generally made after bond approval, the inflow of economic benefits are not yet probable.

We can therefore only include the C25 000 000 in revenue for the current financial year in question (the C5 000 000 received will have to be recognised as a deposit liability).

- *Sales of curios to customers*

  - The revenue is reliably measured at C75 000 (C85 500 X 100/114).
  - The cost of the curios is reliably measurable at C38 500: invoiced price of C50 000 – C1 500 (stolen) – C10 000 (unsold stock on hand at year-end).
  - The significant risks and rewards of ownership were transferred and managerial involvement and effective control ceased when the curios were sold and taken by the customers.
  - Since curios are normally sold on a cash basis and since there is no information provided to the contrary, it is safe to assume that the inflow of future economic benefits are probable.

  Revenue of C75 000 from these sales may therefore be recognised.

- *Sale of produce*

  - The revenue is reliably measured at C2 500 000 (excluding VAT).
  - The cost of the transaction would include the commission, which is reliably measurable at 10% of the selling price: 10% x 2 500 000 = 250 000; the cost would also include the cost of the actual produce sold, which it is safe to assume would be reliably measurable by Burnt Limited.
  - The significant risks and rewards of ownership would be transferred and managerial involvement and effective control would cease when the produce was sold and taken by the customers.
  - Since there is no information provided to the contrary, it is safe to assume that the inflow of future economic benefits is probable.

  Revenue should therefore be recognised at an amount of C2 500 000 (net of VAT). The commission paid to the shopkeeper would be regarded as an expense, and not a reduction in revenue.

Revenue from the rendering of services

When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognised by reference to the stage of completion of the transaction at the the end of the reporting period. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

Solution 4.5 continued …

a) continued …

(a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the entity;

(c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

- *Fees from gape tasting*
  - The revenue is reliably measured at C130 000 (C148 200 X 100/114).
  - It is safe to assume that the cost of the grape tasted would be reliably measurable by Burnt Limited.
  - Given the nature of grape tasting, the stage of completion would always be 'complete'
  - The flow of future economic benefits are probable since grape tasting would normally be paid for at the time of tasting (and no evidence has been provided to suggest that the inflow is not probable).

  Revenue should be recognised at an amount of C130 000.

Revenue from the use by others of an entity's assets (interest)

Revenue arising from the use by others of entity assets yielding interest, royalties and dividends should be recognised when:
(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and
(b) the amount of the revenue can be measured reliably.

- *Interest*

Interest should be recognised on a time proportion basis that takes into account the effective yield on the asset

Revenue from interest amounting to C2 500 will be included. In this instance only 50% of the interest for the two months accrues to Burnt Limited, as the other 50% will be paid to the purchaser on transfer of the property (C250 000 x 12% x 2/12 x 50%).

b) Revenue note disclosure

BURNT LIMITED
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 20X4

		C
8. Revenue		
Sales to customers	(28 500 000 x 100/114 + 85 500 x 100/114 + 2 500 000)	27 575 000
Sales from services rendered	(148 200 X 100/114)	130 000
		27 705 000
Interest received	(250 000 x 12% x 2/12 x 50%)	2 500
Total revenue		27 707 500

Solution 4.6

Recognition of revenue from sale of consignment stock

Revenue from the sale of goods may only be recognised when all of the following criteria are met:

- Significant risks and rewards of ownership are transferred from seller to buyer: although the rewards of ownership have been transferred to Gareth Ltd to the full extent of the C500 000 consignment sales made during the year, (since the profit on the future sale thereof will vest in Gareth Ltd), the risks of ownership remain with Mitch Ltd in respect of the C200 000 of the consignment sales that have not yet been sold at year-end (the goods will ultimately be returned to Mitch Ltd if they are not sold by Gareth Ltd).

- Seller retains neither continuing managerial involvement nor effective control over the goods sold: not met since Mitch Ltd dictates the retail selling price of the goods remaining in Gareth Ltd's shop, worth C200 000

- Amount of revenue can be reliably measured: this criteria is met since the consignment sales price was set at C500 000.

- Costs incurred and to be incurred can be reliably measured: the goods have already been manufactured and therefore the cost thereof would be known to Mitch Ltd.

- Probable that future economic benefits will flow to the seller: past experience seems to suggest that the consignment stock sold to Gareth Ltd *will* be sold to the public at which point Gareth Ltd will owe Mitch Ltd the consignment sales price, (there is no evidence that Gareth Ltd is a bad debt), and therefore, it could be argued that this criteria is met.

Conclusion

Only C300 000 of the consignment sales should be recognised as revenue, since not all recognition criteria for the C200 000 sales have been met.

Solution 4.7

Revenue from services rendered: estate agent's commission

The estate agency has provided a service to the seller (Mr. Caveman) in finding a buyer for his property. The reward for this is the commission. Revenue from services rendered may be recognised when:

- *The amount of revenue can be reliably measured:*
  The commission is reliably measured at C14 000.

- *The costs incurred to date and the costs expected to be incurred to complete the contract can be reliably measured:*
  The costs incurred to date, it is assumed, may be reliably measured. In the case of an estate agency, most legal costs are borne by the seller (or purchaser in certain instances) and the costs of finding a buyer, in terms of petrol and vehicle maintenance costs, are borne by the individual estate agent rather than the estate agency. The costs incurred by an estate agency would therefore be of a general administrative nature (electricity, telephone, rental of premises etc) and include the percentage commission payable to the agent responsible for the sale (in this case C8 000).

- *The stage of completion can be reliably measured:*
  The mandate was to find a purchaser and although this appears to have been achieved, the purchaser is not a confirmed purchaser until the expiry of the 3-month cooling off period. This criteria, it is argued, is not met.

- *It is probable that the future economic benefits will flow to the entity:*
  The commission will only be probable once the 3-month cooling off period has expired and the purchaser has not backed out of the offer. Once this has happened, a firm of lawyers will deduct the commission from the funds collected from the purchaser on behalf of the seller and pay this over to the estate agency and therefore there would seldom be a bad debt.

Conclusion:

The commission of C14 000 should be recognised as revenue only once the 3-month cooling off period has expired and the purchaser has not backed out of the offer. No revenue should, therefore, be recognised in 20X3.

Solution 4.8

a) Discussion

Introduction:
This contract involves revenue from services rendered. Interest has been ignored on the basis that the contract period appears to be relatively short since three of the fifteen floors were completed within one month – and these were the worst floors, suggesting that the entire contract will be completed very soon. Furthermore, no information has been provided when the contract price is to be paid: upfront (which would lead to interest expense for Jillianne Limited), at the end of the contract (which would lead to interest revenue) or piecemeal during the contract (which would probable not result in interest of any kind).

Recognition criteria for revenue from services rendered:
Revenue from services rendered should be recognised when all the following criteria are met:
- Revenue can be reliably measured
- The inflow of economic benefits is probable
- The stage of completion is reliably measurable.
- Costs can be reliably measured

The stage of completion can be measured using:
- Costs to date as a percentage of total costs to date;
- Work certified as a percentage of total contract price; or
- Physical inspection method.

Discussion:
- The revenue can be reliably measured since the contract price has been fixed at C30 000.
- The costs can be reliably measured since this has already been estimated based on past experience to be C18 000.
- The inflow is probable since Jillianne Ltd had many previous dealings with the hotel.
- The stage of completion can be reliably measured based on costs to date as a percentage of total costs to date: C6 000 / C18 000 = 33%
  The physical inspection approach using 3 floors/ 15 floors (20%) would *not* be the most appropriate since the 3 floors include the hotel's most damaged furniture and thus the company has done more than the 20% of the work to date. Similarly, the work certified method would obviously not be appropriate since not certifications have been provided.

Conclusion:
Therefore, 33% x C30 000 = C10 000 should be recognised as revenue in the statement of comprehensive income of Jillianne Ltd for the year ended 31 December 20X4.

b) Journals

20X4 Journals	**Debit**	**Credit**
31 December 20X4		
Cost of services rendered	6 000	
Bank/ Creditor		6 000
Cost of re-upholstery: first 3 floors of hotel		
31 December 20X4		
Debtor	10 000	
Revenue from services rendered		10 000
Revenue from re-upholstery: first 3 floors of hotel:6 000 / 18 000 x 30 000		

Solution 4.9

a) Discussion

Introduction

The issues to be discussed include the recognition and measurement of revenue, of which there are two types within the one sale agreement: sales revenue and interest revenue.

Sales revenue:

Recognition criteria:

- The significant risks and rewards associated with ownership have been transferred from the seller to the buyer;
- Managerial involvement to the extent normally associated with ownership of an asset must have ceased, as should the effective control thereof;
- Revenue is reliably measurable;
- Costs related to the sale are reliably measurable; and
- It is probable that future economic benefits resulting from the sale will flow to the entity.

Discussion:

- The significant risks have been transferred from seller to buyer since Outdoors Limited (the buyer) is responsible for the insurance and transport as of 1 March 20X5; the rewards have been transferred from Caravan Limited to Outdoors Limited since Caravan Limited no longer has physical or legal possession of the caravans whereas Outdoors Limited now does.
- Managerial involvement and effective control by Caravan Limited has ceased evidenced by the fact that Caravan Limited has no physical control over the inventory and is no longer financially involved in the insurance thereof.
- Revenue is reliably measurable at the cash cost per caravan (net of the trade discount): C50 000 x 10 caravans = C500 000
- Costs are reliably measurable using a mark-up of 30% on cost: C58 500 / 130 x 100 = C45 000

The recognition criteria for the recognition of revenue from the sale of the caravans are therefore all met on 1 March 20X5 and therefore revenue of C500 000 must be recognised on 1 March 20X5.

Interest revenue:

Since the caravans were sold on an instalment basis, there is effectively an interest revenue component to this transaction. The amount owing in respect of the sale on 1 March 20X5 is C500 000 and yet only C100 000 was received on this day. This means that the balance of C400 000 was effectively financed.

Interest revenue is recognised and measured using the effective interest rate method, apportioned on a time basis.

The interest rate used by Caravans Limited is 15%. The interest revenue to be recognised each year can therefore be calculated as follows:

Solution 4.9 continued …

a) continued …

W1: Effective interest rate table:

	O/bal	Interest	Bank	C/bal
1 March 20X5	500 000		(100 000)	400 000
28 February 20X6	400 000	60 000	(200 000)	260 000
28 February 20X7	260 000	39 000	(299 000)	0
		99 000	(599 000)	

W2: Time apportionment:

20X5

Interest income: 60 000 x 10/12 = 50 000

20X6

Interest income first 2 months: 60 000 x 2/12 = 10 000
Interest income next 10 months: 39 000 x 10/12 = 32 500
Total = 10 000 + 32 500 = 42 500

20X7

Interest income first 2 months: 39 000 x 2/12 = 6 500

Solution 4.9 continued …

b) Journals

	Debit	Credit
Journals for year ended 31 December 20X5		
1 March 20X5		
Debtor	500 000	
Sales revenue		500 000
Recognition of sale of 10 caravans at 50 000 each		
1 March 20X5		
Cost of sales	450 000	
Inventory		450 000
Cost of 10 caravans sold: 58 500 / 1.3 x 10 caravans		
1 March 20X5		
Bank	100 000	
Debtors		100 000
Receipt of deposit		
31 December 20X5		
Debtors	50 000	
Interest revenue		50 000
Interest income: for calculations, see part (a): W2: 20X5		
Journals for year ended 31 December 20X6		
28 February 20X6		
Bank	200 000	
Debtors		200 000
Receipt of instalment		
31 December 20X6		
Debtors	42 500	
Interest revenue		42 500
Interest income: for calculations, see part (a): W2: 20X6		
Journals for year ended 31 December 20X7 (*not required*)		
28 February 20X7		
Debtors	6 500	
Interest revenue		6 500
Interest income: for calculations, see part (a): W2: 20X7		
28 February 20X7		
Bank	299 000	
Debtors		299 000
Receipt of instalment		

Solution 4.10

W1: Effective interest rate table

	Interest income	Service income	Instalment received	Debtor balance
1 January 20X6	10%			21 528 170
31 December 20X6	2 152 817	600 000	(10 000 000)	14 280 987
31 December 20X7	1 428 099	1 200 000	(10 000 000)	6 909 086
31 December 20X8	690 909	2 400 000	(10 000 000)	(6)
	4 271 824	4 200 000	(30 000 000)	*Rounding error*

		Debit	Credit
1 December 20X6			
Debtor	*2 152 817 x 10 customers*	21 528 170	
Sales			21 528 170
Sale of 10 vehicles			
31 December 20X6			
Debtor		2 752 817	
Interest income	*W1*		2 152 817
Service income	*50 000 x 120% x 10*		600 000
Interest income and service income earned			
Bank	*(1 000 000 x 10)*	10 000 000	
Debtor			10 000 000
Receipt of instalment from debtors (10 customers)			
31 December 20X7			
Debtor		2 628 099	
Interest income	*W1*		1 428 099
Service income	*100 000 x 120% x 10*		1 200 000
Interest income and service income earned			
Bank	*(1 000 000 x 10)*	10 000 000	
Debtor			10 000 000
Receipt of instalment from debtors (10 customers)			
31 December 20X8			
Debtor		3 090 909	
Interest income	*W1*		690 909
Service income	*200 000 x 120% x 10*		2 400 000
Interest income and service income earned			
Bank *(1 000 000 x 10)*		10 000 000	
Debtor			10 000 000
Receipt of instalment from debtors (10 customers)			

Solution 4.11

a) Discussion

Introduction:
This transaction involves two types of revenue:
- Revenue from the sale of goods
- Interest revenue

Discussion: revenue from sale of goods
The revenue from the sale of the machine may only be recognised when all the following criteria are met:
- The significant risks and rewards of ownership are transferred to the buyer.
  The significant risks and rewards are transferred on the date of delivery: 30 November 20X3, when the risks are transferred to the buyer (costs of insurance, maintenance and repairs were then for the account of the customer) and all rewards from the use of the machine will be earned by the buyer. Although the buyer requested that the machine be delivered as soon as possible, the delivery was delayed since the required factory machine was not in stock and due to inefficiencies in the ordering system.
- The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.
  Managerial involvement and effective control by Roger Ltd ceased on 30 November 20X3 when delivery was accepted by the customer and the insurance over the machine was cancelled.
- The amount of revenue can be reliably measured
  The revenue from the sale is the fair value being the net cash selling price that was agreed to at the time of the transaction: C240 000 – C40 000 = C200 000
- It is probable that the economic benefits associated with the transaction will flow to the entity.
  No evidence has been given to suggest that the customer may be a bad debt and furthermore, the customer is one of Roger Ltd's regular customers and therefore we can assume the inflow of future economic benefits to be probable.
- The costs incurred or to be incurred in respect of the transaction can be reliably measured.
  The cost of the machine may be reliably measured based on the invoice price converted into the local currency plus all related and necessary costs of transport and insurance from the date of purchase from the foreign supplier to the date on which it became available for sale locally: C150 000 + C20 000 = C170 000.

Discussion: revenue from interest
Interest revenue should be recognised using the effective interest rate method over the period that the finance is offered. The interest may be calculated as follows:

Year	Opening balance	Interest (at 12.937%)	Instalment (given)	Closing balance
31/11/X4	200 000	25 874	(20 000)	205 874
31/11/X5	205 874	26 634	(20 000)	212 508
31/11/X6	212 508	27 492	(240 000)	0
		80 000	280 000	

The interest should be recognised as follows, measured on a proportionate time basis:
- 31/12/20X3: C25 874 x 1/12 = C2 156
- 31/12/20X4: C25 874 x 11/12 + C26 634 x 1/12 = C25 937
- 31/12/20X5: C26 634 x 11/12 + C27 492 x 1/12 = C26 705
- 31/12/20X6: C27 492x 11/12 = C25 202

Solution 4.11 continued …

a) continued …

Conclusion:
The revenue from the sale of the machine of C200 000 should be recognised on the date of the delivery, that is, 30 November 20X3 whereas the interest should be recognised over the three year period of the financing with C2 156 recognised in 20X3 and C25 937 in 20X4.

20X4 Journals are overleaf …

Solution 4.11 continued …

b) Journals

20X3 Journals		Debit	Credit
9 October 20X3			
Inventory		150 000	
Foreign creditor			150 000
Purchase of a machine: risks and rewards transferred to Roger Ltd on 9 October			
Evidenced by: taking out insurance over goods purchased from this date			
1 November 20X3			
Inventory		20 000	
Foreign creditor			20 000
Costs relating to purchase of machine shipped to Roger Ltd's premises			
Purchase recognised on arrival of goods at Roger Ltd's premises			
30 November 20X3			
Cost of transport and insurance expense		10 000	
Foreign creditor			10 000
Cost of shipping the machine to the customer (selling cost):			
The date of sale is 30 November since the delay was our fault. if the delay had been at the customer's request, the date of sale would have been 1/11			
Debtor		200 000	
Sale			200 000
Sale of a machine (net of discounts: 240 000 – 40 000)			
Cost of sales		170 000	
Inventory			170 000
Cost of sale: 150 000 + 20 000 = 170 000			
15 December 20X3			
Foreign creditor		180 000	
Bank			180 000
Foreign creditor paid			
31 December 20X3			
Debtor	(25 874 x 1/12)	2 156	
Interest			2 156
Interest earned on debtor's balance			
Tax		6 647	
Current tax payable			6 647
Tax on sale and interest less costs incurred:			
(200 000 + 2 156 – 170 000 – 10 000) x 30%			

Solution 4.11 continued …

b) Journals continued …

20X4 Journals	Debit	Credit
30 November 20X4		
Bank	20 000	
Debtor		20 000
First instalment received		
31 December 20X4		
Debtor	25 937	
Interest		25 937
Interest earned on debtor's balance (25 874 x 11/12) + (26 634 x 1/12)		
Tax	7 781	
Current tax payable		7 781
Tax on interest earned on interest income: 25 937 x 30%		

c) Disclosure

ROGER LTD
EXTRACTS FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X3

		Note	20X3 C	20X2 C
Revenue from sales			320 000	100 000
Cost of sales	(50 000 + 170 000)		(220 000)	(60 000)
Gross profit			100 000	40 000
Other income	(80 000 + 60 000 + 92 156 + 10 000) (80 000 + 60 000 + 100 000 + 20 000)		242 156	260 000
Other costs	(60 000 + 10 000)		(70 000)	(50 000)
Finance charges	(just the finance charges incurred)		(100 000)	(110 000)
Profit before tax			172 156	140 000
Income tax expense	(40 000 + 6 647)		(46 647)	(40 000)
Profit for the period			125 509	100 000
Other comprehensive income			-	-
Total comprehensive income			125 509	100 000

Solution 4.12

a)

Introduction and recognition criteria: sale of prepaid vouchers

The recognition criteria relating to revenue from the sale of goods (per IAS 18), given below, needs to be considered:

- The significant risks and rewards of ownership are transferred to the buyer.
- The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.
- The amount of revenue can be reliably measured
- It is probable that the economic benefits associated with the transaction will flow to the entity.
- The costs incurred or to be incurred in respect of the transaction can be reliably measured.

Discussion

- The revenue is reliably measured: C30 000.
- The flow of economic benefits is probable: the cash has already been received.
- In the case of the unredeemed gift vouchers:
  - the revenue is reliably measured: C2 000
  - since the recipient of the certificate has not yet exchanged it for merchandise the cost of the merchandise is not known;
  - since the C2 000 vouchers have not been exchanged for goods, these goods are still in the possession of the seller, and therefore the risks and rewards have not yet transferred from the seller to the buyer and managerial involvement and effective control would also not have ceased.
- In the case of the redeemed vouchers:
  - the revenue is reliably measured: C28 000
  - since the recipient of the certificate has already exchanged it for merchandise the cost of the merchandise would be known;
  - since the vouchers to the value of C28 000 have already been exchanged for goods, the risks and rewards thereof have been transferred and managerial involvement and effective control would also have ceased.

Therefore, only the C28 000 in respect of redeemed vouchers may be recognised; the C2 000 received should be treated as a liability since it is a present obligation to a potential customer. The critical event relative to the recognition of the liability is the supply of the merchandise selected by the customer.

It should be noted that the assumption was made that the certificate could neither be converted into cash nor set-off against an outstanding amount.

b)

If the vouchers had expiry dates, the value of the expired vouchers would be recognised as revenue on expiry date, whereupon the cost of the merchandise would be zero. Until such time as the vouchers are recognised as revenue, they would be recognised as liabilities (income received in advance).

Solution 4.13

Part A: Instalment sale

An installment sale involves two transactions:
- the sale and
- the financing of the sale.

An installment obligates the purchaser to complete all the payments since the purchaser has taken possession of the goods.

The revenue from the installment sale (C1 000 x 5 – interest revenue) may be recognised in the financial statements of Battleship Gallactica Limited when all of the recognition criteria have been met. The recognition criteria are met when:
- the *significant* risks and rewards of ownership have passed to the buyer: since the goods have been delivered, the risks and rewards have obviously passed;
- managerial involvement to *the extent normally associated with ownership and effective control* over the goods ceases: since the goods have been delivered, managerial involvement has ceased;
- the revenue can be reliably measured: C5 000 – interest calculated on the effective interest rate method;
- the costs are reliably measurable: using either the supplier invoice or working back from the selling price to the cost price by using either the entity's gross profit percentage or mark up; and
- it is probable that the economic benefits associated with the transaction will flow to the entity: no evidence to the contrary was provided.

The interest element included in the installments should be recognised over the period of the installment sale contract using the effective interest rate method.

Part B: Lay away sale

A lay away sale does not involve financing and, since the goods are not collected by the purchaser until all installments are paid, there is no obligation for the purchaser to complete all the payments.

The revenue from the lay away sale (C1 000 x 5) may be recognised in the financial statements of Battleship Gallactica Limited when the goods are delivered. However, if experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the buyer.

Solution 4.14

Introduction

Revenue is defined by IAS 18 as:

- the gross inflows of economic benefits;
- during the period;
- arising in the course of ordinary activities of an entity;
- when those inflows result in increases in equity,
- other than increases relating to contributions from equity participants.

In terms of the contract C3 000 will be paid to Sporty Limited and meets the definition of revenue in that:

- the C3 000 is a gross inflow of economic benefits,
- the amount will be received/receivable in the current period,
- as a result of the ordinary activities of the gym (the gym's primary business is to provide the client with gym facilities), and
- the amount is not a contribution from the equity participants (not a sale of shares).

The selling of the gym contract should therefore be recognised as revenue in the financial statements of Sporty Limited.

The sale of a gym contract must be assessed in order to determine if it is either:

- A sale of goods;
- Rendering of services; or
- Royalties, interest or dividends.

The provision of gym facilities to gym members is a rendering of a service.

Revenue from the rendering of services is recognised when all the following criteria are met:

- the revenue can be reliably measured;
- the costs can be reliably measured (costs incurred to date and costs still to be incurred);
- it is probable that the economic benefits expected will flow to the entity; and
- the stage (percentage) of completion can be reliably measured.

A discussion of these recognition criteria is provided below:

- The revenue is stated in the contract as C3 420. This amount includes VAT. The revenue must be calculated as C3 420 x 100/114. The revenue is therefore reliably measurable at C3 000, (with a VAT liability owing to the tax authority of C420).
- Since the gym has been opened for eleven months, there is sufficient past experience upon which to base a reliable estimate of the cost involved in providing these services.
- Since the contract price is paid before the services are provided, the inflow of economic benefits are not only probable but certain.
- The stage of completion in this case is the most difficult to estimate. The following are the three methods from which to choose:
  - surveys of work performed;
  - services already performed as a percentage of the total services to be performed; and
  - the costs incurred to date as a percentage of the total costs to be incurred.

Solution 4.14 continued …

In the case of Sporty Limited none of the above methods would be appropriate. Although research has proven that the contracts would be used 80% in the first year, 15% in the second and 5% in the third year, the revenue should not be recognised in this pattern. Even if the client does not utilise the gym in the second and third year, the gym would still be obliged to make the service available to the user. According to IAS 18, 'when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed' (IAS 18, para 25). Since there is no one significant act, it would be appropriate to recognise the revenue evenly over the period of the contract.

Conclusion

The amount received is therefore revenue received in advance and should initially be recognised as a liability, and reversed evenly over the contract period to revenue: C1 000 per year. Where the contract is sold during a year, the C1 000 would have to be calculated on a pro-rata basis e.g. a sale on 1 October in the current year, would require the current year revenue to include C1 000 x 3/12 = 250.

Solution 4.15

a)

- Warthogs Limited only retain an insignificant risk of ownership in that on average only 2% (2/100) of broomsticks are defective.

    - Warthogs is able to reliably/reasonable estimate repair and replacement costs thereby warranting the recognition of revenue at the date of sale.
    - An appropriate provision for repairs/ replacements in terms of the warranty contract should be recognised/raised at the date of sale.

- It is probable that there will be an inflow of economic benefits in the form of sales revenue (C750 per broomstick sold) which can be reliably measured in terms of the sales agreement.

- Warthogs is able to reliably measure the costs of each broomstick sold (C750/125% x 100% = C600).

- Once the broomstick has been sold, Warthogs no longer has any managerial involvement in the use of the broomstick.

Therefore, since the recognition criteria for a sale are all met, Warthogs Limited should recognise revenue at the date of sale and recognise a warranty provision for the estimated repair/ replacement costs.

b)

The installation of the air-conditioning unit constitutes a significant portion of the sales price:

- The rewards of ownership have not been transferred to the buyer until the air-conditioning unit has been installed and is operational at the buyer's premises.

- The revenue is able to be reliably measured as it is stipulated in the sale agreement and it is probable that economic benefits will flow to the entity once the air-conditioning unit has been successfully installed.

- Warthogs Limited relinquishes managerial involvement in the air-conditioning unit only once the unit has been installed.

- The costs incurred by Warthogs to distribute and to install the unit can only be reliably measured once the unit has been installed. (Or: a reliable estimate of the costs that will be incurred by Warthogs Limited to distribute and install the unit is probably possible based on past experience).

Therefore, since all the recognition criteria for the sale will only be met on installation of the system, Warthogs Limited should only recognise revenue arising on the sale of an air-conditioning unit, once installation is complete.

Solution 4.15 continued . . .

c)

- Prior to the purchaser being awarded the contract, Warthogs retains a significant portion of the risks of ownership.

- Although the sales amount can be reliably measured there is uncertainty at the date of the sale surrounding the probability of the return (inflow of benefits) which is contingent on the purchaser being awarded the contract. This could have an impact on the measurement of the sales revenue if the contract is only awarded much later (i.e. the revenue may need to be measured at the present values of future sales revenue).

- Warthogs Limited will only relinquish managerial involvement in the lawnmower once the purchaser has been awarded the gardening contract.

- A reliable estimate of the cost of the lawnmower is probably possible based on past experience.

Therefore, since all the recognition criteria for the sale will only be met when it is certain that the purchaser will be granted the gardening contract, Warthogs Limited should only recognise the revenue when it is certain that the purchaser will be granted the gardening contract.

d)

- Since the newspapers have been sold on consignment and the number of newspaper sales to the public is not predictable, Warthogs Limited has not transferred the risks of ownership (i.e. the risk of the costs associated with producing the paper not being recouped).

- The amount of revenue can only be reliably measured once Warthogs knows the number of newspapers sold.

- Warthogs Limited will only relinquish managerial involvement in the newspapers once they have been sold to the public (all unsold newspapers will be returned to the Warthogs Limited).

- A reliable estimate of the cost of the newspapers is probably possible based on past experience.

Therefore, revenue should only be recognised when Warthogs is certain of the number of papers sold on their behalf. Prior to this stage the probability of an inflow of benefits is uncertain based on the unpredictability of newspaper sales.

Solution 4.16

a)

In terms of IAS 18 Revenue, in order to reflect the substance of the transaction it may be necessary to apply the recognition criteria to the separately identifiable components of a single transaction. The sale of a Caris 1600, including service plan, to Mr Nick has two separately identifiable components: one being the sale of the vehicle and the second being the sale of a service plan. Each component needs to be discussed and recognised separately.

The sale of the motor vehicle:
In order for revenue to be recognised on the sale of the vehicle to Mr Nick, all of the following conditions need to be met:

- The significant risks and rewards of ownership must be transferred. The significant risks and rewards of ownership are transferred to Mr Nick, the buyer on 1 April 20X6 when Mr Nick takes delivery of the vehicle. From this date Mr Nick is responsible for insuring and maintaining the vehicle and receives the rewards from the use of the vehicle.
- No management involvement or control over the vehicle must exist. Jabulani Motors retains neither continuing management involvement nor control over the vehicle once Mr Nick has taken delivery of the vehicle: Jabulani Motors no longer has physical possession of the vehicle and is no longer responsible for insuring the vehicle.
- The amount of revenue must be able to be reliably measured. The amount of revenue can be measured reliably as the price has been agreed to in Mr. Nick's signed offer to purchase. The revenue attributable to the sale of the vehicle is C142 220 (C147 500 – C5 280 [NOTE 1] relating to the service plan – see below for calculations).
- The inflow of economic benefits must be probable. This criteria is met since Mr Nick has entered into a loan agreement with Tafcat bank, which paid the full amount of C147 500 to Jabulani Motors on 1 April 20X6.
- The costs incurred must be reliably measurable. The costs incurred in respect of the transaction can be measured reliably since Jabulani Motors works on a standard 25% gross profit percentage: C142 220/ 100% x 75% = C106 665

As all of the above conditions have been met Jabulani Motors Limited should recognise revenue from vehicle sales of C142 220.

NOTE 1: The revenue from the services of 5 280 would normally have been present valued and then this present value would have been deducted from the total price of 147 500. This was not done in this question since the question indicated that discounting should be ignored.

The sale of the service plan:
In terms of IAS 18, the outcome of the sale of the service plan can be measured reliably when all of the following conditions are met:

- The amount of revenue must be able to be reliably measured. The amount of revenue can be measured reliably as customers are usually charged C880 for a service and the plan either covers 5 years or 90 000km. This means that, at most, 6 services (90 000km/ 15 000km), would be performed. Therefore C5 280 (C880 x 6 services) of the total selling price would be attributable to the service plan.
- The inflow of economic benefits must be probable. It is probable that the economic benefits associated with the transaction will flow to the entity, given that Jabulani Motors received the full price of C147 500 (which includes the C5 280 for the services) from Tafcat Bank on date of sale (i.e. 1 April 20X6).
- The stage of completion must be able to be reliably measured. The stage of completion of the transaction can be measured reliably at the end of the reporting period based on the number of services performed to date as a percentage of 6 total services. Mr. Nick's first service was performed in August 20X6, which means that at 30 September 20X6, the percentage complete is 16.7% (or 1/6).

Solution 4.16 continued …

a) continued …

- The costs incurred and the costs to complete the transaction must be reliably measurable. The costs incurred for the transaction and the costs to complete the transaction can be measured reliably as Jabulani Motors marks up the cost of parts and labour on services by 33 1/3% and the selling price (C880) of a service is known. This means that the cost of the service must be C660 (880 / 133% x 100%), and to complete the remaining service will cost, at most C3 300 (5 remaining services x 660).

Revenue in respect of the service plan must be measured using the percentage completion method, using the number of services performed to date as an indicator of the percentage completed. The revenue should therefore be recognised as follows:

- The revenue for one service should be recognised in the financial statements at 30 September 20X6: C880 (5 280 x 1/6);
- the balance of the service revenue must be deferred as a liability (and presented as a current liability) until the remaining services have been performed or the 5 year period has expired: C4 400 (5 remaining services x 880).

Note: the receipt of the 147 500 on date of sale, including an amount for services, suggests that there is an element of financing and that interest expense should therefore be recognised. The question has indicated that the effects of discounting should be ignored thus this complication was ignored.

Solution 4.16 continued …

b)

JABULANI MOTORS LIMITED
EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME
FOR YEAR ENDED 30 SEPTEMBER 20X6

		Notes	C
Revenue	*Sales: C142 220 x 100 + Services: 70 400 (W1)*	3	14 292 400
Cost of sales and services	*C14 222 000/ 100% x 75% + C70 400/ 133.3% x 100%*		10 719 300

W1: (5 280 x 100 x 20% x 1/6) + (5 280 x 100 x 30% x 2/6) and W2: 880 x 6 services = 5 280

JABULANI MOTORS LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AS AT 30 SEPTEMBER 20X6

		C
EQUITY AND LIABILITIES		
Current liabilities *		
Service revenue received in advance	C5 280 x 100 – 70 400	457 600

** the services could be earned over a period of 5 years or could be earned over a shorter period if the driver completes the 90 000 km maximum mileage before the 5 year limit. A more prudent approach would be to assume that the liability is a current liability rather than a long-term liability.*

JABULANI MOTORS LIMITED
EXTRACT FROM NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 SEPTEMBER 20X6

		C
3. Revenue		
Revenue comprises:		
Sales of motor vehicles	*100 x 142 220*	14 222 000
Servicing of motor vehicles	*100 x 20% x 5 280 x 1/6 + 100 x 30% x 5 280 x 2 / 6*	70 400
		14 292 400

Solution 4.17

a)

Introduction
The issue is whether the amounts received should be treated as revenue (income earned in the current period) or as a liability (income received in advance). The nature of the revenue *could* be seen as either a sale of goods (in this case the cards) or the rendering of a service. In this case, it is argued that the most important/ significant aspect of the transaction is the rendering of a service by Born 2 Speak rather than the sale of a mere plastic card.

The revenue recognisable must be subject to the recognition criteria in IAS 18, 'Revenue'. The recognition of a liability must be as per The Framework.

Revenue

Revenue is defined in IAS 18 as:
- Gross inflows of economic benefits,
- During the year,
- Arising from ordinary activities,
- Resulting in increases in equity other than an increase arising from contributions of equity participants.

According to The Framework, income (including revenue) can only be recognised when the increase in economic benefits:
- is probable and
- can be measured reliably.

Although there has legally/ technically been a 'sale', revenue will be recognised as 'revenue from services' (since the resultant ability to use the card to make calls for 3 months, being a provision of a service, is the most significant aspect to the 'sale' transaction). The revenue from such 'sale' transactions must therefore be recognised based on the recognition criteria relevant to 'provision of services' transactions.

As per IAS 18, the revenue should be measured by reference to the stage of completion, once the outcome of the transaction can be estimated reliably.

The revenue recognition criteria for services rendered are as follows:

Revenue should be reliably measured
Revenue is measured in terms of the selling price per card (excluding VAT) multiplied by the number of cards sold.

Probable that economic benefits will flow to the entity
Because the amount is paid in advance, the economic benefits have already flowed to the entity.

Stage of completion must be reliably measured
This will relate to the extent to which users have utilised the services that they were entitled to.
- For Airtime cards, this can be calculated over the 3 month life.
- For Call cards, this can be based on experience, past usage or a computerised check.

Solution 4.17 continued …

a) continued …

Reliable measurement of costs
It is reasonable to assume that the entity will be able to reliably measure the cost of its cards and its services.

Liability
The portion of amounts received to date that relate to services not yet rendered, should be recognised as a liability, being income received in advance.

A liability is defined in The Framework as:
- A present obligation of the entity
- As a result of a past event
- That will result in the outflow of economic benefits.

For a liability to be recognised, The Framework sets out recognition criteria as follows:
- the outflow of economic benefits must be probable; and
- the cost should be measured reliably.

Discussion:
- The obligation exists as the company has to provide services to the purchasers of the cards.
- The past event was the sale of the cards by the company which creates the obligation of service.
- The outflow of economic benefits will be in the form of resources used by the entity when providing the service in respect of its obligations.
- Reasonable to assume that outflow of benefits are probable and can be reliably measured.

Tax consequences – assuming that income received in advance is taxed in the year of receipt while accounted for in the books on an accrual basis, a temporary difference and therefore deferred tax would arise on this transaction.

VAT consequence – the VAT is received on behalf of the tax authorities and is thus not included as part of the income.

Conclusion

The proceeds can be divided into revenue and a liability. The revenue is earned from the rendering of a service and as a portion of the receipt complies with that definition, that portion of the receipt should be recognised as revenue.

The accrual basis of accounting requires the recognition of the effects of transactions when they occur (and to the period to which they relate) and not as cash is received or paid.

The portion of cash received for which a service is still to be rendered should therefore be recognised as a liability: the entity has an obligation to provide a service in respect of the coverage to be provided.

Solution 4.17 continued …

b)

		Dr	Cr
Bank/ Debtors (A)		15 686 400	
Revenue (I)	*(8 500 000 + 4 480 000)*		12 980 000
Revenue received in advance	*(500 000 +280 000) (L)*		780 000
Output VAT (L)	*(15 686 400 x 14/114)*		1 926 400
Cash received over the year			
Commission expense	*(1 495 000 100 / 114)*	1 311 404	
Input VAT (A)	*(1 495 000 14 / 114)*	183 596	
Liability/ Bank	*(90 000 + 59 500) x 10*		1 495 000
Cash paid over the year			

Workings

W1: **Number of cards sold**	**Airtime cards (units)**	**Call cards (units)**
Amount sent to retailers	100 000	60 000
Unsold at retailers	10 000	500
Therefore, total cards sold to customers	90 000	59 500

W2: **Revenue generated by 'sales'**		**Total receipts (including VAT)**	**VAT liability**	**Total revenue**	**Revenue Recognised in 20X2**	**Revenue received in advance (L)**
Airtime cards	90 000 x C114; 10 260 000 x 14/114; 10 260K – 1 260K;	10 260 000	1 260 000	9 000 000	[(a)]8 500 000	[(a)]500 000
Call cards	59 500 x C91.20 5 426 400 x 14/114 5 426 400 – 666 400	5 426 400	666 400	4 760 000	[(b)]4 480 000	[(b)]280 000
		15 686 400	1 926 400		12 980 000	780 000

Airtime cards

Of the 90 000 airtime cards sold to customers, the entity still has to render services in respect of the cards sold in November and December. Since research indicates that most sales occur at the beginning of the month and that usage is constant over the three month service period, almost all airtime cards sold in October would have expired by year end. The amount of service to be provided can be calculated by dividing the number of cards by 3 to obtain a monthly figure based on the facts that sale occurs at the beginning of the month and usage is even over the 3 months:

- In respect of November's sales, only one month of service is owed as at December. This can be calculated as: (3000/3) x 1 = 1 000.
- In respect of December sales, two months service is owed at year end date. This can be calculated as: (6000/3) x 2 = 4000
- By adding the units of service owed, we come to a total of 5 000 units still owed at year end.

The sales of 90 000 cards should therefore be recognised as follows:

- 85 000 (90 000 – 5 000) cards should be recognised as revenue: C100 x 85 000 = C8 500 000;
- 5 000 cards should be recognised as a liability: C100 x 5 000 = C500 000.

Note: The unit price is taken excluding VAT: C100 = (C114 x 100/114)

Solution 4.17 continued …

Workings continued …

Call cards

Of the 59 500 cards sold, the entity is only liable to provide a service on 1 000 cards to the extent of 100% and 5 000 cards to the extent of 50%. Therefore in total, an obligation exists for 3 500 units:

- [1 000 (1 000 x 100%) + 2 500 (5 000 x 50%)].

The sales of 59 500 cards should therefore be recognised as follows:

- 56 000 cards (59 500- 3 500) as revenue: C80 x 56 000 = C4 480 000;
- 3 500 cards as a liability at year-end: C80 x 3 500 = C280 000.

Note: The unit price is taken excluding VAT: C80 = (C91.20 x 100/114)

Summary

Airtime Cards	100 000 – 10 000 = 90 000 x R100	=	R9 000 000	**R**	85 000 x R100	=	R8 500 000
				L	5000 x R100	=	R500 000
							R9 000 000
Call cards	60 000 – 500 = 59 500 x R80	=	R4 760 000	**R**	56 000 x R80	=	R4 480 000
				L	3 500 x R80	=	R280 000
							R4 760 000

Solution 4.18

a) Initial recognition and measurement

IFRIC 13 paragraph 5 states that paragraph 13 of IAS 18 must apply to the accounting of loyalty points.

Loyalty points should be recognised as a separately identifiable component of the sales transaction in which they are granted. The fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale. Therefore, the recognition of the C1 000 must be split into two components, namely revenue attributable to the sale of the actual product and the revenue attributable to the awarding of loyalty points.

Revenue relating to the sale of the goods

To recognise an amount of sales revenue, the criteria per IAS 18 for sales transactions must be met:

- The risks and rewards of ownership must pass to the customer. The entity immediately transfers the good to the customer.

- The entity must retain neither managerial involvement usually associated with ownership nor effective control. The purchased goods are transferred to the customer on date of sale and there is no indication that management has any further involvement with the goods.

- The inflow of future economic benefits must be probable. All sales are cash sales and therefore there is no risk that the inflow is not probable.

- The amount of revenue can be reliably measured – The components of the actual sale of the product can be calculated by netting off the calculation of revenue attributable to the loyalty points, from the total revenue of the sale.

- The costs incurred/to be incurred must be reliably measurable. The costs appear to be reliably measurable since the entity uses an efficient standard costing system.

The entity must *recognise* the revenue attributable to the sale of the product since all recognition criteria are met.
The *measurement* of the revenue from the sale of the actual product is calculated as the amount after deducting the revenue from the sale of the points. The revenue from the sale of the points would be measured as follows:

- Number of points x value per point = C1 000 / C10 x C1 = C100

The revenue from the sale of the actual goods is therefore measured as follows:

- Total revenue – revenue from sale of points = C1 000 – C100 = C900.

Revenue attributable to the loyalty points.

IFRIC 13 states that if the entity supplies the awards itself (as in Naty Ltd's case), it must recognise the consideration allocated to award credits as revenue when awards credits are redeemed and it fulfils its obligations to supply awards. The amount of revenue recognised is based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

Solution 4.18 continued …

b) Journal entries for sale in part (a)

	Debit	Credit
30 November 20X8		
Bank	1 000	
Revenue (actual sale of good)		900
Unearned income (loyalty award)		100
Initial recognition of the sale		

Workings

Sale = C1 000
C10 = 1 loyalty point
Therefore C1 000 = 100 loyalty points
Therefore C100 of the sale is attributable to the loyalty award
Therefore C900 of the sale is attributable to the actual sale of the good.

c) Journal entries for 20X8

	Debit	Credit
31 December 20X8		
Unearned income (loyalty award)	50 000	
Revenue (loyalty award)		50 000
Recognition of revenue relating to the loyalty points redeemed		

Workings

C1 000 000 total sales
C10 = 1 loyalty point
Therefore C1 000 000 = 100 000 loyalty points (1 000 000/100)
And 1 loyalty point has a FV of C1
Therefore 100 000 points = C100 000

Total points estimated to be redeemed = 80% = 0.8 x 100 000 = 80 000

Therefore % redeemed in 20X8 = 40 000/80 000 = 50%
Therefore total revenue recognised relating to loyalty points awarded =
0.5 x C100 000 = C50 000

Solution 4.18 continued …

d) Journal entries for 20X9

20X9 Journals	Debit	Credit
31 December 20X9		
Unearned income (loyalty award)	40 000	
Revenue (loyalty award)		40 000
Recognition of revenue relating to the loyalty points redeemed		

Workings

Total points estimated to be redeemed = 90% = 0.9 x 100 000 = 90 000

Therefore % redeemed in 20X9 = 81 000/90 000 = 90% {81 000 = 41 000 + 40 000}
Therefore total revenue recognised relating to loyalty points awarded =
0.9 x C100 000 = C90 000
But C50 000 was recognised in the 20X8 year
Therefore C40 000 should be recognised in the 20X9 year {90 000 – 50 000}

Solution 4.19

All of the above scenario's deal with the sale of goods. From the information provided it is clear to see that the both the criteria of reliably measuring cost (C12 000) and revenue (C15 600) are met. The three scenario's below focus on the *other* criteria.

Customer A

- The customer paid the amount in full and thus the flow of economic benefits is certain.
- The customer also has taken delivery of the goods and *rewards* have transferred to him.
- The issue, which requires special attention here, is the passing of the *risks* of ownership and whether Retail Therapy's management is still involved in the transaction.

IAS 18.16 provides examples of where significant risks may be retained by the entity.
One of the examples listed involves the presence of a warranty provision. IAS 18.17 explains that revenue should be recognised if the risk of ownership is insignificant and that the risk is 'insignificant' if the seller can reliably estimate future returns and recognise a liability for returns based on previous experience.

Retail Therapy should therefore recognise this revenue since:
- A sale has been made with a warranty (being a risk that ownership will be retained), but
- Past experience is available to draw on in order to reliably estimate the warranty provision (therefore this risk of ownership being retained is deemed to be insignificant).

No provision would, however, be recognised in the case of customer A since past experience indicates that this customer never returns goods and that goods are never faulty: therefore no return is expected.

Customer B

- The customer has taken delivery of the goods and thus risks and rewards have been transferred to him, Retail Therapy's management is also no longer involved and no longer has effective control over the goods. Retail Therapy now has a right to receive payment from customer B.

The issue that requires more deliberation is whether or not it is probable that the economic benefits associated with the transaction will flow to Retail Therapy.

As the customer was known to have a criminal record for fraud and no creditworthiness test was done, there is significant uncertainty that the future economic benefits will flow in. This means that:
- No asset may be recognised (the recognition criteria are not met); and
- Revenue may not be recognised (the recognition criteria are not met).

For practical purposes though, a journal entry must be passed in order that a debtor's statement is generated from the accounting system (debtors statements are normally automatically generated from the debtors account and therefore, if we do not debit this account, no statement will be posted to the customer and therefore, would be failing as a business to recover the money owed to it).

The following journal is suggested (the net effect is that the debtors balance in the statement of financial position is nil and revenue is not recognised, thus complying with both the Framework and IAS 18).

Solution 4.19 continued …

	Debit	Credit
Debtors	15 600	
Unrecognisable debtors allowance (-'ve asset)		15 600
Sale to customer B (fraud crime): uncertain inflow of FEBs. Revenue to be recognised when received.		

Customer C

- The customer, at the time of the sale, was expected to fulfil his obligation to pay in full based on the fact that he was a reliable and long standing customer and therefore the flow of economic benefits was reasonably certain.
- The customer had taken delivery of the goods and therefore risks and rewards had been transferred.

It would thus have been appropriate, according to IAS18, to recognise revenue at this stage.

IAS 18.18 states that when an uncertainty arises about the collectibility of an amount already included in revenue, this uncollectible must be recognized as an expense and not an adjustment to revenue.

It is thus clear that the C15 600 owing by this customer must be written off as a bad or doubtful debt expense, depending on the company's assessment of the probability of recoverability. Either one of the following journals would then be appropriate:

	Debit	Credit
Doubtful debt expense	15 600	
Doubtful debts allowance (-'ve asset)		15 600
Customer C has skipped the country and therefore the recoverability is in question		

OR

	Debit	Credit
Bad debt expense	15 600	
Debtors		15 600
Customer C has skipped the country and therefore the recoverability is not expected: balance owing is written-off		

Part 2

Chapter 5
Accounting for taxation

Question	Key issues
5.1	Understanding provisional payments
5.2	Ledger accounts and disclosure of taxation expense and current tax asset/ liability
5.3	Calculation of provisional payments
5.4	Journal entries, ledger accounts and disclosure
5.5	Current normal tax: basic calculations and disclosure
5.6	Calculation of normal tax: (taxable profit includes a capital gain); disclosure
5.7	Calculation of normal tax: (taxable profit includes a temporary and permanent differences); disclosure
5.8	VAT on companies
5.9	Disclosure of taxation on statement of comprehensive income, statement of financial positions and notes
5.10	Statement of comprehensive income, statement of changes in owners equity and notes to financial statements
5.11	Current normal tax: calculation and journals: involving accruals with opening & closing balances
5.12	Current normal tax: calculation and journals: involving accruals with opening & closing balances
5.13	Current normal tax calculations and journals

Question 5.1

"The accountant says we underprovided for last year's tax, yet we showed a current tax asset in last year's statement of financial position. I can't understand what he's talking about!"

Required:

Explain how the above situation could have arisen and how the under provision should be accounted for.

Question 5.2

The following information relates to Misty Ridge Limited, which commenced business on 1 January 20X1. The financial year-end of the company is 31 December.

		C
First year		
30 June 20X1	Provisional payment	26 000
31 December 20X1	Provisional payment	28 000
31 December 20X1	Provided for taxation	56 000
16 April 20X2	Amount of assessed normal tax on taxable profit	56 000
16 May 20X2	Paid assessment	
Second year		
30 June 20X2	Provisional payment	29 000
31 December 20X2	Provisional payment	30 000
31 December 20X2	Provided for taxation	58 000
19 May 20X3	Amount of assessed normal tax on taxable profit	59 500
19 June 20X3	Paid assessment	
Third year		
30 June 20X3	Provisional payment	31 000
31 December 20X3	Provisional payment	31 500
31 December 20X3	Provided for taxation	65 000
18 April 20X4	Amount of assessed normal tax on taxable profit	64 800
18 May 20X4	Paid assessment	
Fourth year		
30 June 20X4	Provisional payment	33 000
31 December 20X4	Provisional payment	34 000
31 December 20X4	Provided for taxation	67 400

All companies are required to make the provisional payments of tax during its financial year – the first, half way through the financial year or earlier and the second on or before the last day of the year

Required:

a) Prepare the current tax liability/ asset and taxation expense ledger accounts for the four years 20X1 to 20X4.
b) Show the relevant disclosure in the annual financial statements of Misty Ridge Limited for the four years ended 31 December 20X1 to 20X4 in respect of the above transactions.

Question 5.3

Part A
The accountant of Koogi Ltd. made the following estimates of the taxable profit for the year ended 31 December 20X9:

- On 30/6/20X9: estimated taxable profit for the year of C40 000
- On 31/12/20X9: estimated taxable profit for the year of C50 000
- On 30/4/20Y0: (when preparing the financial statements for the year ended 31/12/X9) estimated taxable profit for the 20X9 year of C40 000

Tax on taxable profits is levied at 30%.

Part B
Assume the same information in part A above, with the exception that the estimated taxable profit on 31/12/20X9 for the purpose of calculating provisional tax amounted to C30 000.

Part C
Assume the same information in part A above, with the exception that the estimated taxable profit on 31/12/20X9 for the purpose of calculating provisional tax amounted to C15 000 and the amount of assessed normal tax on taxable profit was C10 000, (not C14 000 per 'e' and 'f' of the required).

Assumption: Assume two provisional tax payments are required to be made as per the tax laws during the year.

Required:

For each of Part A, B and C above, calculate:

a) The amount of the first provisional payment

b) The amount of the second provisional payment

c) The amount shown in the statement of comprehensive income as current tax for the year ended 31/12/20X9

d) The balance on the current tax liability/ asset account shown in the statement of financial position as at 31/12/20X9 assuming a zero opening balance at the beginning of the year.

e) Assuming that the amount of assessed normal tax on taxable profit was C14 000, calculate whether there is an under/over-provision of current tax in the following financial year, in respect of 20X9. If so calculate the amount.

f) Assuming the same additional information given in (e) above (the amount of assessed normal tax on taxable profit was C14 000 for 20X9) determine whether a refund is due by the tax authorities or whether a payment with return is due to the tax authorities during the following financial year in respect of 20X9. Calculate the amount.

Question 5.4

Wak Limited is a company with a financial year ending on 28 February. The following information relates to the financial years 20X6, 20X7 and 20X8:

	20X8	20X7	20X6
	C	C	C
Profit before tax	16 700	15 200	12 000
Tax expense	5 845	5 320	4 200
Tax payments made during the year	5 950	5 000	4 000
The amount of assessed normal tax on taxable profit for:			
20X6 – Assessment received during 20X7 financial year			4 600
20X7 – Assessment received during 20X8 financial year		4 825	
20X8 – Assessment received during 20X9 financial year	6 000		

- Any amounts owing to or by the tax authorities (as a result of the tax authority's amount of assessed normal tax on taxable profit not equalling the accountants estimate) are settled in the year the assessment is received.
- There was no amount owing to the tax authority in respect of years prior to 20X6.
- There are no components of other comprehensive income.
- The tax on taxable profit remained 35% over the three years.

Required:

For each of the financial years in question, prepare journal entries to record the above transactions, enter the journal entries in the relevant ledger accounts, and show how the above information would be disclosed in the annual financial statements of Wak Limited.

Question 5.5

The following information has been provided in respect of Big Blue Ltd, a company that began operations in 20X2:

- The tax expense in the statement of comprehensive income for 20X3 is C83 650 (20X2: C87 000).
- The balance owing to the tax authority per the statement of financial position as at 31 December 20X2 was C5 000.
- The amount of assessed normal tax on taxable profit for 20X2 finalized during 20X3, stating that the tax for 20X2 (before taking into account any payments made during 20X2) was C85 900.
- The total payments made to the tax authority in respect of normal income tax during 20X3 is C80 000 (including the provisional payments for 20X3 and any payment with return/ refund in respect of 20X2).

- There was a capital profit of C13 000 (non-taxable), dividend income of C5 000 (non-taxable) and a fine of C500 (non-deductible for tax purposes) during 20X3.
- Profit before tax in 20X3 is C300 000 (20X2: C290 000).
- The rate of normal income tax is 30% on taxable profits. The tax rates have remained unchanged since 20X2.

Required:

Prepare, in accordance with the International Financial Reporting Standards and to the extent that information is available, the:

a) Taxation expense note for the year ended 31 December 20X3

b) Statement of financial position as at 31 December 20X3;

Accounting policy notes are not required.

Comparative figures are required

Question 5.6

The profit before tax of Zac Ltd for the year ended 31 December 20X2 of C500 000 includes the following items:

- Profit of C100 000 on sale of a building. The original cost was C300 000 and its carrying amount and tax base were both C280 000 on the date of the sale. Assume that the Sale Proceeds for tax purposes shall be taken up to the maximum of the cost of building.

- Dividend income of C10 000 is taxable at 10%.

- Donations of C50 000 (not deductible).

- Traffic fines of C30 000 (not deductible).

There are no components of other comprehensive income.

The applicable tax rate was 30% on taxable profits. Assume that no dividends were declared during the year and that there were no temporary differences during the year.

Required:

a) Calculate the taxable profit and current tax.

b) Show how this will be disclosed in the statement of comprehensive income and taxation note for the year ended 31 December 20X2 in accordance with International Financial Reporting Standards.

Question 5.7

Wac Ltd has profit before tax of C250 000 for the year ended 31 December 20X1. When calculating this figure, the following information was correctly accounted for:

- Unearned sales income of C24 000 received in advance in respect of 20X2 (taxable in the current year).

- Interest income of C7 000 is receivable (taxable in the current year)
- Telephone payment of C5 000 is due for 20X1 but has not yet been paid (deductible for tax purposes in the current year)
- The rent for the first month in 20X2 of C10 000 has already been paid (deductible for tax purposes in the current year).
- Dividend income of C12 000 was earned during 20X1 taxable at 10%
- A donation of C8 000 was paid during 20X1 (not deductible for tax purposes)
- Depreciation of C40 000 was expensed during the year. The tax depreciation is of C25 000.

There are no components of other comprehensive income.

The applicable tax rate is 30% on taxable profits. There are no other permanent or temporary differences other than those apparent from the above information.

Required:

a) Calculate the current tax and show the related journal entries.

b) Show the disclosure of taxation in the statement of comprehensive income and taxation expense note for the year ended 31 December 20X1 in accordance with International Financial Reporting Standards.

Ignore deferred taxation.

Question 5.8

BG Ltd, registered as a vendor for VAT purposes, has the following transactions for the month of March 20X9:

- Bought inventories with a marked price of C200 000 from a non-VAT vendor.
- Bought inventories from a VAT vendor. The invoice totalled C33 000.
- Sold inventories to Mr. A (a non-VAT vendor) with an invoice value of C800 (includes VAT).
- Sold inventories to Mr. B (a VAT vendor) with an invoice value of C12 000 (includes VAT).
- Paid electricity and water: C420 (includes VAT).
- Paid telephone of C190 (includes VAT).
- Paid salaries of C20 000 in cash. Employees' tax owing to the tax authority as a result came to C8 000. VAT is not levied on salaries.

- Paid C11 000 employees' tax during the month and there was a balance owing at the beginning of the month of C6 000.

- The balance on the VAT account at the beginning of the month was C2 000 (debit).
- A VAT refund of C5 000 was received during the month of March 20X9.

- Dividend income of C12 000 was earned during the month. VAT is not levied on dividends.

- Dividends of C18 000 were declared during the month. VAT is not levied on dividends.

Rate of VAT is 14%.

There are no components of other comprehensive income.

Required:

a) Journalise the above transactions.

b) Show how the above would be disclosed in the financial statements of BG Ltd for the month of March 20X9.

Question 5.9

The following balances were extracted from the books of Peach Limited at 31 May 20X6:

	C	
Profit before tax	115 000	(Cr)
Dividends paid – 30 November 20X5	15 000	(Dr)
Provisional tax payments	43 000	(Dr)

Additional information

- Included in the profit before tax are dividends received of C8 000, other expenses of C40 000 and interest paid of C2 000.

- The company declared a final dividend of C10 000 on 31 May 20X6.

- Taxation for the year has not yet been calculated. Assume all revenue included in profit for the year to be taxable and all expenses to be deductible. The normal tax rate is 35% on taxable profits and the tax rate on dividend income is 10%

- As the assessed amount of normal tax on taxable profit was received in May of the current year from the tax authority in respect of the 20X5 tax year which showed that there had been an under provision of C1 500 in that year.

- There are no components of other comprehensive income.

Required:

a) Prepare the statement of comprehensive income of Peach Limited for the year ended 31 May 20X6 (starting with the gross profit).

b) Prepare the statement of financial position of Peach Limited at 31 May 20X6.

c) Prepare the taxation note for the financial statements of Peach Limited.

Question 5.10

The financial director of Caribbean Limited is in the process of finalizing the financial statements for the year ended 28 February 20X7. The trial balance at that date is as follows:

CARIBBEAN LIMITED
TRIAL BALANCE AT 28 FEBRUARY 20X7

	Debit	Credit
Ordinary share capital		3 000 000
Share premium		1 500 000
Distributable reserves		1 424 200
Borrowings		2 000 000
Accounts payable		400 000
Accrued expenses		20 000
Property, plant and equipment	4 200 000	
Accounts receivable	1 100 000	
Accrued income	15 000	
Inventory	1 800 000	
Tax Refundable	200 000	
Cash at bank	2 059 200	
Revenue		12 000 000
Cost of sales	7 100 000	
Net operating expenses	3 480 000	
Interest on borrowings	240 000	
Share issue expenses	150 000	
	20 344 200	20 344 200

The following information is relevant:

- The authorized share capital comprises 10 000 000 ordinary shares of 0.50c each. During the year, 1 000 000 shares were issued at a price of C2.00. The issue of the shares has been correctly recorded in the accounting records. Share issue expenses of C150 000 were paid. The financial director wishes to account for these expenses with the minimum impact on distributable reserves.

- The borrowings relate to a loan taken out by Caribbean Limited on 1 July 20X4 for a three year period. The company does not have the right to defer settlement of the loan.

- The balance on the property, plant and equipment comprises land with a carrying amount of C3 150 000 and plant and equipment with a carrying amount of R1 050 000. Property is measured at revalued amount and plant and equipment is measured at cost.

- At year end, the directors engaged the services of an independent valuer who has valued the property at C3 950 000. There is no intention to sell the land. The managing director, who is not an accountant but has been perusing the IASB website, has queried whether the revaluation surplus should be recognized as income based on the following paragraph in IAS 1: "An entity shall recognize all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise." (IAS 1, para 88).

- During the year, an item of plant and equipment was sold for C330 000. This item of plant had cost C300 000 and to date of sale accumulated depreciation and tax allowances amounted to C120 000. The sale of the plant has been correctly recorded in the accounting records and has been netted off against the operating expenses.
- The inventory has a net realizable value of C1 720 000 and the accounts receivable are expected to realize C980 000.
- Included in the operating expenses are depreciation of property, plant and equipment amounting to C210 000, salaries of C1 800 000, advertising of C35 000, repairs to equipment of C28 000 and auditors remuneration of C110 000.
- Dividends of five cents per share were declared on 25 March 20X7. The financial statements were authorized for issue on 30 March 20X7.
- The financial director wishes to present the statement of comprehensive income and the statement of financial position in accordance with the requirements of IAS I.

The current normal income tax rate is 29%.

Required:

a) Prepare the statement of comprehensive income of Caribbean Limited for the year ended 28 February 20X7, in accordance with International Financial Reporting Standards

b) Prepare the statement of changes in equity of Caribbean Limited for the year ended 28 February 20X7, in accordance with International Financial Reporting Standards

c) Prepare the current liabilities section of the statement of financial position of Caribbean Limited at 28 February 20X7, in accordance with International Financial Reporting Standards

d) Prepare the following notes to the financial statements in accordance with International Financial Reporting Standards

- Statement of compliance and accounting policy for basis of preparation
- Share capital, profit before tax, taxation expense and dividends

Ignore deferred tax

Question 5.11

Gripping Limited has provided you with the following extracts of its draft financials for the year ended 31 December 20X3:

	20X1 C	20X2 C	20X3 C
Profit before tax	300 000	400 000	450 000
Included in the profit before tax is:			
- donations to various charities	40 000	0	
- profit on sale of vehicle	50 000	0	
- depreciation on machine (purchased in yr 2) (Tax depreciation: 25 000 in year 2 and 25 000 in year 3)	0	15 000	15 000
- profit on sale of this machine (cost 70k, sales proceeds 80K)	0	0	40 000

Income received in advance (closing balance)	20 000	10 000	40 000
Expenses prepaid (closing balance)	30 000	40 000	20 000

The following tax related information has been provided to you:

	20X1	**20X2**	**20X3**
	C	**C**	**C**
Capital gain on sale of vehicle/ machine	15 000	n/a	?
Provisional tax payments	60 000	70 000	100 000
Tax payment with return for previous year (assume payments made in full)	n/a	?	?
Tax for year 1 (per assessment received during year 2)		94 000	
Tax for year 2 (per assessment received during year 3)			114 500

- There were no other assets or liabilities other than those mentioned above.
- There were no other permanent or temporary differences other than those mentioned above.
- 20X1 is the first year of operations.

Required:

Provide all journal entries relating to the current normal for each of the years ended 31 December 20X1, 20X2 and 20X3. Ignore deferred tax.

Question 5.12

Alaska Limited *correctly* calculated profit before tax of C885 000 *after* taking into account the following:

- Depreciation on office equipment of C110 000 in 20X8. The local tax authority allowed the deduction of C80 000 capital allowances on this equipment in 20X8.
- Rental income received in advance (taxable when received):
  - 31 December 20X7: C6 500
  - 31 December 20X8: C7 500
- Insurance expense prepaid:
  - 31 December 20X7: C3 000
  - 31 December 20X8: C6 000
- A provision for leave pay of C50 000 was raised on 31 December 20X8. The tax authority only allows this to be deducted when paid.
- A profit was made on sale of machinery of C150 000. The machine was acquired on 1 January 20X6 at a cost of C600 000 and sold on 31 December 20X8. Depreciation is calculated at 25% p.a. straight line to a nil residual value. Capital allowances of 20% p.a. straight line are granted.
- A VAT penalty of C6 000 was paid for late payment of VAT.

- Total tax depreciation for the year of assessment is C170 000.
- The 20X5 tax assessment arrived in June 20X6 and reflected current normal tax of C234 000.
- The first provisional tax payment was made on 31 December 20X5 on an estimated taxable income of C600 000.
- The second provisional tax payment was made on 30 June 20X6 on an estimated taxable income of C405 000.
- The C11 350 owing at the beginning of the year was paid on 1 September 20X5.
- The corporate normal tax rate is 30%.
- There are no other permanent or temporary differences other than those evident from the information above.

Required:

a) Calculate the current normal tax for the year ended 30 June 20X6.

c) Prepare all the journals relating to current tax for the year ended 30 June 20X6.

- A non-deductible traffic fine of C1 000.
- Dividends received of C60 000.
- The tax assessment for 20X7 arrived in 20X8 and indicated taxable profits of C700 000. Current normal tax of C230 000 was recorded in 20X7.
- The corporate normal tax rate is 30% for both 20X7 and 20X8.
- Dividends are exempt from tax.
- The balance owing to the tax authorities at 31 December 20X7 was C8 000.
- Payments of C200 000 have been made to the tax authorities during 20X8.

Required:

a) Calculate the current normal tax for the year ended 31 December 20X8.

b) Prepare the journal entries relating to current tax, the accruals and the provision.

Question 5.13

DCI Limited has correctly calculated profit before tax of C535 000. An extract from the statement of comprehensive income for the year ended 30 June 20X6 is as follows:

	20X6
	C
Donation (non-deductible: for tax purpose)	30 000
Donation (deductible: for tax purpose)	50 000
Depreciation on plant and machinery	190 000
Profit on sale of plant	30 000
Impairment of machinery	20 000
Profit on sale of machine	?

An extract from the statement of financial position for the year ended 30 June 20X6 is as follows:

	20X6	**20X5**
	C	**C**
Accrued expenses	4 000	11 000
Expense prepaid	17 000	18 000
Income received in advance	5 500	8 900
Current tax payable	?	11 350

- The profit on sale relates to plant that was sold for C230 000 and had originally cost of C800 000. Total capital allowances claimed to date on the plant are C400 000 (up to and including the 20X6 financial period).
- An item of machinery (not the item impaired above) was sold during the year. The depreciation on this machine is included in the C190 000 depreciation mentioned above. Accounting profit realised was C120 000. Its cost was C100 000, carrying amount of C80 000 and a tax base of C90 000 on the date of sale.

Part 2

Chapter 6
Taxation and deferred taxation

Question	Key issues
6.1	Basic calculation of current tax and deferred tax, journal entries, ledger accounts, disclosure
6.2	Basic calculation of current tax and deferred tax, journal entries, disclosure
6.3	Basic calculation of current tax, deferred tax, disclosure with ledger accounts
6.4	Relating tax and deferred tax to the accounting framework
6.5	Calculations, journal entries, ledger accounts, disclosure and discussion requiring an understanding of temporary differences arising from capital allowances and year-end accruals
6.6	Calculation of deferred tax and current tax, journal entries, statement of financial position note disclosure
6.7	Calculation of current tax, deferred tax, journal entries: Part A: no rate change Part B: with rate changes
6.8	Statement of comprehensive income, statement of financial position and note disclosure: Part A: no rate change Part B: with rate changes
6.9	Temporary differences relating to capital allowances Part A: basic calculations and journals with no sale of asset Part B: calculations, journals and disclosure with sale of asset at below cost
6.10	Disclosure of tax expense note and including overprovision
6.11	Deferred tax calculation and journal entries for depreciable asset, income received in advance and expenses prepaid
6.12	Calculation of normal income tax (current and deferred), and policies incorporating statement of cash flows
6.13	Journal entries and disclosure: relating to current tax, deferred tax and overprovision
6.14	Journal entries, statement of comprehensive income and tax expense note (depreciable asset and year-end accruals)
6.15	Deferred tax loss recognised
6.16	Deferred tax loss un-provided
6.17	Deferred tax loss
6.18	Calculation of current and deferred tax
6.19	Deferred tax involving accruals with opening & closing balances
6.20	Deferred tax involving accruals with opening & closing balances

Question 6.1

The profit before tax of Look Limited for the year ended 28 February 20X1 is C100 000. Included in this amount are the following:

Capital profits (not taxable)	50 000
Donations (not deductible)	30 000

Expenses prepaid of C40 000 were correctly accounted for. These expenses are allowed as a deduction for tax purposes in 20X1. There were no other temporary or permanent differences other than those evident from the information given.

There is no other information/ transaction that affects the current tax payable/ receivable account. There are no components of other comprehensive income.

The normal tax rate is 30%.

Required:

a) Calculate the current tax and deferred taxation for 20X1.

b) Show the ledger accounts for current and deferred tax for the 20X1 year.

c) Prepare the tax expense note.

d) Show the journal entries relating to tax in the 20X1 year.

e) Prepare extracts from the statement of comprehensive income for the year ended 28 February 20X1.

Comparatives and notes are not required.

f) Prepare extracts from the statement of financial position as at 28 February 20X1.

Comparatives and notes are not required.

Question 6.2

At 30 June 20X6 the statement of financial position of Eye Limited included a deferred tax liability amounting to C11 152. The deferred tax relates to the only item of equipment owned by the company.

The following particulars are supplied:

	For the year ended 30 June	
	20X8	**20X7**
Profit before tax	282 000	252 000
Tax depreciation	40 000	50 000
Accounting depreciation	48 000	48 000

- The tax base of the equipment at 30 June 20X6 was C356 120.
- The current normal tax for the year ended 30 June 20X7 is paid in July 20X8. No other tax payments were made.
- There are no components of other comprehensive income.
- Assume a constant tax rate of 40%.

Required:

a) Show the journals relating to tax and depreciation for the years ended 30 June 20X7 and 30 June 20X8.

b) Prepare extracts from the statement of financial position of Eye Limited at 30 June 20X8 and statement of comprehensive income and notes to the financial statements for the years ended on that date in accordance with the requirements of International Financial Reporting Standards.

Question 6.3

Phobie Limited, with no expenses and no income other than rent income, received the following cash over two years:

- Received in 20X1: rent income of C10 000 in respect of 20X2
- Received in 20X2: rent income of C110 000 in respect of 20X2

The normal tax rate has remained constant at 30% over both years. Rent is taxed on receipt basis.

Required:

a) Calculate profit before tax, as it would appear in the statement of comprehensive income.

b) Calculate the taxable profit and current taxation for both 20X1 and 20X2.

c) Calculate the effective rate of tax over both years (separately and in total) assuming that only current tax is recognised (no deferred tax is recognised).

d) Show the ledger accounts for 20X1 and 20X2, taking deferred tax into account.

e) Show how this will be disclosed in the tax expense note.

f) Show the journal entries relating to tax and year end accruals for 20X1 and 20X2.

Question 6.4

Walnut Limited has a new and inexperienced financial accountant who insists that an estimate of current normal corporate tax should not be processed in its financial statements for the year ended 31 December 20X3. His reasoning is that the official 20X3 tax assessment has not yet arrived and he believes that it is only once this official assessment has been received that the amount will be known and a liability can be recognised.

He is also of the opinion that the deferred tax liability of C50 000 shown in the statement of financial position as at 31 December 20X2 should be reversed since this does not meet the definition of a liability.

Neither current tax nor deferred tax has been processed in Walnut Limited's current 20X3 financial statements. The auditors are therefore requesting that Walnut Limited include the following in the 20X3 financial statements:

- Current normal tax of C80 000 in respect of 20X3;
- An under-provision of current normal tax relating to 20X2 of C7 000; and
- A deferred normal tax liability of C60 000.

Required:

a) Explain by way of a discussion of the relevant definitions and recognition criteria whether or not the current normal tax liability and related tax expense of C80 000 should be raised.

You are not required to discuss either the under-provision of prior year current tax of C7 000 or the deferred tax liability of C60 000.

b) Provide all relevant tax-related journal entries that you believe should be processed by Walnut Limited in order to finalise its financial statements for the year ended 31 December 20X3.

Closing transfer entries are not required.

Question 6.5

The following deferred tax working papers of Blue Cheese Limited have been partially prepared at 28 February 20X2.

	Carrying amount	Tax base	Temporary difference	Deferred tax
Property, plant & equipment:				
Balance – 28/02/20X1	145 000	115 000		
Balance – 28/02/20X2	120 000			
Rent received in advance:				
Balance – 28/02/20X1	(2 000)			
Balance – 28/02/20X2	(5 000)			
Interest income receivable:				
Balance – 28/02/20X1	0			
Balance – 28/02/20X2	20 000			

Deferred tax summary	Property, plant and equipment	Rent received in advance	Income receivable	Total
Balance – 28/02/20X1	?	?	?	?
Balance – 28/02/20X2	?	?	?	?

There were no purchases or sales of property, plant and equipment during the year ended 28 February 20X2. The company tax consultant has confirmed the income tax treatment of the above items for the year ended 28 February 20X2 as follows:

Statement of financial position item	Income tax treatment
Rent received in advance	Taxable in the year of receipt
Interest income receivable	Taxable in year interest is earned
Tax depreciation	C30 000

The profit before tax is C100 000 and there are no permanent or temporary differences other than those that may be evident from the information provided.

The normal tax rate is 30%.

The 'current tax payable: normal tax' account had a credit balance of C10 000 on 1 March 20X1. No payments were made to the tax authority during the year ended 28 February 20X2.

Required:

a) Complete the deferred tax working paper.

b) Calculate current normal tax.

c) Show the related ledger accounts.

d) Disclose all information possible in the statement of financial position of Blue Cheese Limited.

Notes are not required.

e) Show the deferred tax note in the financial statements of Blue Cheese Limited as at 28 February 20X2.

f) For each statement of financial position item on the deferred tax working paper, explain the conceptual meaning of the carrying amount and tax base, and thereby justify the resulting temporary difference and deferred tax. In preparing your answer, bear in mind the following quotation:

"The objective of this IFRS is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's statement of financial position"

(IAS 12, Income taxes, Objective)

Question 6.6

Fish Ltd is a company operating in the food industry. The following information has been presented to you:

FISH LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 20X3

	20X3 C	20X2 C
Property, plant and equipment	?	355 000
Expenses prepaid (this is allowed as a deduction for tax purposes in 20X3)	10 000	0
Income received in advance (taxable in the year of receipt)	28 000	15 000

Additional information:

- The tax base of the property, plant and equipment balance at 31 December 20X2 was C290 000.
- During 20X3 depreciation was C35 000 and tax depreciation allowed was C25 000. There was no other movement of property, plant and equipment during 20X3.
- Profit before tax is C300 000.
- Dividend income of C5 000 was earned during 20X3. Dividend income is taxable at 10%
- There are no other temporary or permanent differences other than those evident from the information provided.
- The normal income tax rate is 30%.

Required:

a) Calculate the deferred normal income tax balance at 31 December 20X2 and 31 December 20X3.

b) Calculate the current normal income tax for the year ended 31 December 20X3.

c) Journalise the current and deferred normal income tax adjustments for the year ended 31 December 20X3.

d) Disclose the deferred tax note to the statement of financial position as at 31 December 20X3 in accordance with International Financial Reporting Standards.

Question 6.7

The information given below is in respect of Factory Limited, a manufacturing company:

- Factory Limited owned two manufacturing plants: one had been purchased on 1 January 20X1 for C200 000 and the company then built a second plant at a cost of C500 000. The first plant was put into operation on 1 January 20X1 (the same day of

acquisition), whereas the second plant was completed on 30 June 20X1 but only became available for use on 1 January 20X2, on which date it was brought into production.

- Depreciation is provided at 20% per annum on the straight-line basis to nil residual values. The tax authorities allow tax depreciation on the full cost of plant over four years, apportioned from the date on which it was brought into use.

- The company earned profits before taxation and before depreciation of C200 000 in all three years.

- The opening balance on the deferred tax account in the statement of financial position was zero on 1/1/20X1.

- There are no other temporary or permanent differences other than those that may be evident from the information provided.

Part A:
Assuming that the normal tax rate remained at 35% for all years affected:

Required:

a) Calculate the current normal taxation for the years ending 31 December 20X1 to 20X3.

b) Calculate the deferred normal tax charge using the income statement approach for the years ending 31 December 20X1, 20X2 and 20X3.

c) Journalise the entries for current tax and deferred tax for each of the years ended 31 December 20X1, 20X2 and 20X3.

d) Prove the balance on the deferred tax asset / liability account using the balance sheet approach (comparing the carrying amounts and tax base of the machines).

Part B:
Assuming that the normal tax rate is 35% in 20X3 but 45% in 20X2 and 40% in 20X1:

Required:

a) Calculate the current normal taxation for the years ending 31 December 20X1 to 20X3.

b) Calculate the deferred normal tax charge using the income statement approach for the years ending 31 December 20X1, 20X2 and 20X3.

c) Journalise the entries for current tax and deferred tax for each of the years ended 31 December 20X1, 20X2 and 20X3.

d) Prove the balance on the deferred tax asset / liability account using the balance sheet approach (comparing the carrying amounts and tax base of the machines).

Question 6.8

The draft statement of comprehensive income of Hobbit Ltd for the year ended 31 December 20X1 is shown below:

HOBBIT LIMITED
DRAFT STATEMENT OF COMPREHENSIVE INCOME

	C
Revenue	1 000 000
Cost of sales	(400 000)
Gross profit	600 000
Other income	300 000
Other expenses	(403 000)
Profit before taxation	497 000
Other comprehensive income	-
Total comprehensive income	497 000

The following end of year adjustments need to be accounted for:

- Rent received in advance of C5 000 is included in 'other income' (taxable in 20X1).
- Rates prepaid of C6 000 in respect of 20X2 are included in 'other expenses' (deductible for tax purposes in 20X1).
- Advertising costs payable at year-end total C10 000 (deductible for tax purposes in 20X1).
- Interest income of C20 000 is receivable at year-end (taxable in 20X1).

Other relevant information:

- Dividend income of C30 000 is included in 'other income' (exempt from tax).
- Fines of C9 000 are included in 'other expenses' (not deductible for tax purposes).
- Dividends of C80 000 have been declared on 30 December 20X1.
- The deferred tax account at 31 December 20X0 had a credit balance of C12 000 which related purely to taxable temporary differences arising from capital allowances on plant. The tax base of the plant at 31 December 20X0 was C115 000. At 31 December 20X1 the carrying amount of the plant amounted to C120 000 and the tax base amounted to C85 000. No plant was sold or purchased during the year.

Part A
Assume that the statutory normal tax rate has remained unchanged for many years at 30%.

Required:

a) Prepare an extract from the statement of comprehensive income of Hobbit Limited for the year ended 31 December 20X1, starting with profit before tax.

Comparatives are not required.

b) Show how deferred tax will be disclosed on the statement of financial position of Hobbit Limited at 31 December 20X1.

c) Prepare the notes to the financial statements relating to taxation and deferred tax at 31 December 20X1.

Comparatives for the tax expense note are not required.

Part B
Assume that the statutory normal tax rate was 40% up to 31 December 20X0 and that the rate changed to 30% during the year ended 31 December 20X1.

Required:

a) Prepare an extract from the statement of comprehensive income of Hobbit Limited for the year ended 31 December 20X1, starting with profit before tax.

Comparatives are not required.

b) Indicate how deferred tax will be disclosed on the statement of financial position of Hobbit Limited at 31 December 20X1.

c) Prepare the notes to the financial statements relating to taxation and deferred tax at 31 December 20X1.

Comparatives for the tax expense note are not required.

Question 6.9

Make Limited bought a manufacturing plant on 1 January 20X2 and put it into production immediately.

- The plant cost C500 000 and had a useful life of five years.
- Make Limited depreciates plant over 5 years (straight-line to nil residual value).
- The tax authorities allows tax depreciation on the following basis:
  - 50% of the cost in the first year
  - 30% of the cost in the second year
  - 20% of the cost in the third year
- The profit before taxation in 20X5 was C150 000 (20X4: C120 000).
- The tax rate remained constant at 40% from 20X2 to 20X5.
- The company's financial year ends on 31 December.
- There are no other temporary or permanent differences other than those evident from the information given.
- Plant is the only item of property, plant and equipment.

- There are no components of other comprehensive income.

Part A

Required:

a) Calculate deferred tax using the balance sheet approach for 20X2 to 20X6.

b) Calculate the taxable profit and current tax expense for 20X4 and 20X5.

c) Journalise the deferred tax adjustments for each of the years 20X2 to 20X6 and journalise the current tax for 20X4 and 20X5.

Part B

Use the same information but that the plant was sold for C100 000 on 31 December 20X5:

Required:

a) Calculate deferred tax using the balance sheet approach for 20X2 to 20X5.

b) Calculate the taxable profit and current tax expense for 20X4 and 20X5.

c) Journalise the deferred tax adjustments for each of the years 20X2 to 20X5 and the current tax for 20X4 and 20X5.

d) Disclose the relevant information, with comparatives, in the financial statements of Make Limited for the year ended 31 December 20X5 in accordance with International Financial Reporting Standards.

Question 6.10

The following information relates to Root Limited for its financial year ended 31 December 20X6:

- Profit before tax for the year ended 31 December 20X6 has been correctly calculated at C344 000.

- Included in the profit before tax for the year ended 31 December 20X6 are the following items, amongst others:

	C
Dividend income- taxable at 10%	200 000
Profit on sale of vehicle	100 000
Depreciation	(150 000)

- The following balances have been extracted from the trial balance at 31 December 20X6:

	C
Income received in advance: 31 December 20X6 (31 December 20X5: 10 000)	130 000
Expenses prepaid: 31 December 20X6 (31 December 20X5: 15 000)	7 000

- The tax authorities:
  - granted tax depreciation of C270 000 as a deduction in 20X6;
  - tax income received in advance in the year of receipt; and
  - allow the expenses prepaid as a deduction for tax purposes in the year in which they are paid.

- A vehicle was sold during 20X6. On the date of sale, its carrying amount was C700 000, and its tax base was C650 000. Its original cost was C750 000.

- The tax assessment for the 20X5 tax year was received in August 20X6 and showed an assessed tax on taxable profit amounting to C 48 000. The total tax expense as reported on the 20X5 statement of comprehensive income amounted to C98 000, comprising current normal tax of C52 000, deferred normal tax of C46 000. No journal entries have yet been processed to take into account any adjustments that may be necessary.

- The deferred tax balance at the beginning of the year is C16 500 (credit) whereas the deferred tax balance at the end of the year is C900 (debit).

- Dividends of C220 000 were declared in 20X6.

- The normal tax rate is 30%.

- There are no permanent or temporary differences other than those presented in the above information. All amounts are considered material.

- There are no components of other comprehensive income.

Required:

a) Show how the tax expense note is disclosed in the annual financial statements of Root Limited for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

   Comparatives are not required.

b) Prepare an extract from the statement of comprehensive income of Root Limited for the year ended 31 December 20X6 beginning with the line item 'profit before tax'.
   Notes are not required.

   Comparatives are not required.

Question 6.11

Tree Limited is preparing its annual financial statements for the year ended 31 December 20X6. The following information is relevant:

TREE LIMITED
EXTRACT OF TRIAL BALANCE AT 31 DECEMBER

	20X6 Dr/ (Cr)	20X5 Dr/ (Cr)
Income received in advance	(123 000)	(0)
Expenses prepaid	0	5 000
Property, plant and equipment	150 000	1 000 000
Current tax payable: normal tax	?	(6 000)
Deferred tax: normal income tax	?	(16 500)

- Income received in advance is taxed in the year of receipt whereas expenses prepaid are deducted for tax purposes in the year of the payment.
- The tax base of property, plant and equipment at 31 December 20X6 was C30 000.
- During 20X6, the assessment showed that the current normal tax in 20X5 was overprovided by C4 000.
- The current normal tax was calculated at C57 600 for the 20X6 tax year.
- Provisional normal tax payments made during 20X6 amounted to C30 000.
- There are no other temporary differences other than those evident from the information provided above.
- The normal tax rate is 30% (unchanged for many years).
- There are no components of other comprehensive income.

Required:

a) Process all journal entries affecting the tax expense account for the year ended 31 December 20X6.

b) Prepare, in accordance with International Financial Reporting Standards, the following extracts from the annual financial statements of Tree Limited:

- the statement of financial position at 31 December 20X6
- the deferred tax note at 31 December 20X6

Comparatives are required

Question 6.12

Bean Limited is a company that assembles, distributes and rents cappuccino and espresso machines for the coffee shop, society and the home market. It began operations on 1 July 20X4 and uses one major item of equipment to assemble its products.

- The company purchased the assembly equipment on 1 July 20X4 at a cost of C900 000. The equipment is depreciated on the straight line basis over its estimated useful life of ten years, with no residual value. The tax authority grants an allowance of 20% per annum, not apportioned for time.

  The financial accountant has prepared the following schedule relating to deferred taxation at 30 June 20X6, *before* the impairment of the asset:

		Accounts	Tax Base	Timing Difference	Deferred Tax (X29%)
Equipment					
01/07/X4	Cost	900 000	900 000		
30/06/X5	Depreciation / tax allowance	(90 000)	(180 000)		
		810 000	720 000	90 000	26 100
30/06/X6	Depreciation / tax allowance	(90 000)	(180 000)		
	Preliminary balance	720 000	540 000	180 000	52 200

  At 30 June 20X6, there are indications that the equipment is impaired. An impairment test is performed and the recoverable amount is estimated at C600 000. The remaining useful life is estimated to be five years with no residual value. The impairment is recorded correctly in the accounting records.

  The equipment was sold on 30 October 20X6 for an amount of C500 000.

- The directors decided to rent equipment rather than buying new equipment. The rent is payable six monthly in advance and an amount of C270 000 was *paid* on 1 November 20X6 and on 1 May 20X7. Expenses paid in advance are deductible for tax purposes when paid.

- Bean Limited *receives* rental income in advance in relation to coffee machines that it rents to coffee shops. Rental income received in advance at 30 June 20X7 amounts to C20 000. There was no rental income received in advance at 30 June 20X6. Income received in advance is taxed when received.

- The financial accountant has prepared the following schedule relating to current taxation:

	Year end 30/06/X7	Year end 30/06/X6	Year end 30/06/X5
Amount provided for current normal tax	?	?	135 100
1st and 2nd provisional payments	146 000	142 000	130 000
Balance on current tax payable account	?	?	5 100
Amount of assessed normal tax on taxable profit	Not yet received	162 100	132 200

  The company paid the balance owing on assessment in December 20X5 (for the year ended June 20X5) and in December 20X6 (for the year ended June 20X6).

- The profit before taxation of the company has been correctly calculated at C520 000 for the year ended 30 June 20X6 and at C700 000 for the year ended 30 June 20X7. All accounting entries relating to the equipment, the rent paid and the rent received have been correctly included in the calculation. The profit before tax for both years also includes dividend income of C40 000 for 20X6 and C30 000 for 20X7. No dividends were paid during either year.

- The financial accountant has extracted the following balances relating to the trading activities:

	Year end 30/06/X7		Year end 30/06/X6	
	Debit	**Credit**	**Debit**	**Credit**
Sales		3 500 000		2 600 000
Accounts receivable	196 000		184 000	
Bad debts expense	14 000		9 000	
Inventory	240 000		115 000	
Accounts payable		174 000		102 000

- There are no components of other comprehensive income.

- The normal company tax rate for all years is 29%.

Required:

a) Show how deferred tax would be reported on the statement of financial position of Bean Limited at 30 June 20X7.

Comparative figures are required.

b) Show how current tax would be reported on the statement of financial position of Bean Limited at 30 June 20X7.

Comparative figures are required.

c) Prepare the accounting policies note (incorporating policies for basis of preparation, deferred tax and equipment) ***and*** the taxation note of Bean Limited for the year ended 30 June 20X7.

Comparative figures are required.

d) Prepare the *operating activities* section of the statement of cash flows of Bean Limited for the year ended 30 June 20X7.

*Comparative figures are **not** required*

Question 6.13

Universal Fitness is a company that operates a chain of gyms in Gauteng. The trial balance of Universal Fitness at 31 December 20X7 is as follows:

UNIVERSAL FITNESS
TRIAL BALANCE AT 31 DECEMBER 20X7

	Debit	Credit
Ordinary share capital		200 000
Retained earnings		1 770 725
Long-term loan		500 000
Deferred tax (31/12/X6)		66 525
Accounts payable		286 000
Unearned income		63 750
Profit before dividend income and interest		2 410 000
Dividends received		15 000
Land at cost	2 470 000	
Administration buildings (at carrying amount)	1 600 000	
Equipment (at carrying amount)	630 000	
Accounts receivable	380 000	
Prepaid expenses	25 000	
Current tax asset/ liability	102 000	
Interest expense	75 000	
Dividends	30 000	
	5 312 000	5 312 000

The following information is relevant:

1. Profit before dividend income and interest has been correctly calculated and includes the depreciation on both the administration building and the equipment as well as a donation to 'Save the Penguin Fund' of C20 000. The 'Save the Penguin Fund' is not a recognised charity in terms of the Income Tax Ordinance.
2. Assume that the tax authority does not grant any tax allowance on the administration buildings. The depreciation for the year ended 31 December 20X7 amounts to C120 000.
3. The tax base of the equipment at 31 December 20X7 is C364 000. For the year ending 31 December 20X7, depreciation on equipment amounts to C170 000 and the tax allowance amounts to C188 000.
4. The unearned income is taxed in the year of receipt and the prepaid expenses are deductible in the year of payment.
5. The deferred tax balance at 31 December 20X6 comprises a taxable temporary difference on the equipment of C248 000 and a deductible temporary difference on the unearned income of C26 250.
6. The tax assessment for the 20X6 year was received during 20X7 and showed that the amount of the assessed tax on taxable profit was C5 000 less than the amount provided for current normal tax in the previous year.
7. Other than mentioned above, all income is taxable and all expenses are deductible.
8. The normal tax rate is 30%.

Required:

a) Prepare the journal entries to be processed at the end of the year to account for the current tax, deferred tax and overprovision.

b) Prepare all the notes relating to tax expense and deferred tax in accordance with International Financial Reporting Standards.

Accounting policies are not required

Question 6.14

Rainy Limited is a company involved in the manufacture of wellington boots. Its financial year ends on 31 December.

- The following balances (not yet recognized in statement of comprehensive income) have been extracted from its trial balance at 31 December 20X6:

Rent income received in advance: 31 December 20X5	10 000
Expenses prepaid: 31 December 20X5	15 000

- The following has been recognised in statement of comprehensive income:
  - Rent income received in advance at 31 December 20X6 totalled C8 000. Income received in advance is taxed in the year of receipt.
  - Expenses prepaid at 31 December 20X6 totalled C7 000. Expenses prepaid are deductible for tax purposes in the year in which they are paid.
- Other than the processing of provisional payments made during 20X6 (which totalled C180 000), no other journal entries have yet been processed regarding tax expense.
- Tax depreciation of C270 000 was granted as a deduction in 20X6 by the tax authorities.
- The tax assessment for the tax year 20X5 was received in August 20X6. It reflected an amount of C48 000 for the assessed normal tax on taxable profit for 20X5. The total tax expense in the statement of comprehensive income in 20X5 was disclosed as C98 000, being made up of current normal tax of C52 000, deferred normal tax of C46 000. No journal entries have yet been processed to take into account any adjustments that may be necessary.
- A vehicle with a carrying amount of C700 000 (and tax base of C650 000) was sold during 20X6. Its original cost was C750 000.

The draft results of operations for the year ended 31 December 20X6 is shown below.

RAINY LIMITED
DRAFT RESULTS OF OPERATIONS
FOR THE YEAR ENDED 31 DECEMBER 20X6

	20X6 C
Sales	800 000
Rent income	50 000
Dividend income	200 000
Profit on sale of vehicle	100 000
Cost of sales	(300 000)
Depreciation (all depreciation relates to sales representative vehicles)	(150 000)
Interest expense	(120 000)
Other expenses	(80 000)
Dividends declared (30 June 20X6)	(220 000)
Amount to be carried forward to Retained Earnings	280 000
Retained earnings: 1 January 20X6	60 000
Retained earnings: 31 December 20X6	340 000

- Other expenses are allocated to the entity's core functions as follows:
  - Distribution: 30%
  - Administration: 20%
  - Other: 50%
- All amounts are considered material.
- The deferred tax balance at the beginning of the year is C42 000 (debit) whereas the deferred tax balance at the end of the year is C22 800 (debit).
- There are no components of other comprehensive income.
- The normal tax rate is 30% and dividend income is exempt from tax.

Required:

a) Process all journal entries required to finalise the financial statements for the year ended 31 December 20X6.

Closing journal entries are not required.

b) Prepare the statement of comprehensive income, using the function method (disclosing the analysis of costs by function on the face of the statement of comprehensive income)

c) Prepare the tax expense note to be included in the annual financial statements of Rainy Limited for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

Question 6.15

Liquid Limited is a listed company in the retail industry. The financial statements are currently being prepared for the year ended 31 December 20X3.

- Liquid limited made a profit before tax of C30 000 in 20X3 (20X2: C20 000 and 20X1: C14 000)
- Dividend income received during the year was C10 000 (20X2:C10 000 and 20X1:C10 000)
- Information relating to property plant and equipment

	20X0	20X1	20X2	20X3
Carrying amount	70 000	64 000	48 000	36 000
Tax base	90 000	70 000	50 000	30 000

- There are no other temporary or permanent differences other than those referred to above.
- Liquid Limited has sufficient appropriate evidence available to suggest that they will be able to utilise their deferred tax assets.
- The normal income tax rate is constant at 30% and dividend income is taxed at 10%.

Required:

a) Calculate the current normal tax and deferred normal tax.

b) Prepare the tax-related journals for the years ended 31 December 20X1, 20X2 and 20X3.

c) Prepare the tax expense and deferred tax note for the years ended 31 December 20X1, 20X2 and 20X3.

Question 6.16

Reflection Limited is a listed company manufacturing mirrors. The financial results for the year ending 20X3 are:

- Profit before tax is C30 000 in 20X3 (20X2: C20 000 and 20X1: C14 000)
- Dividend income received during the year was C10 000 (20X2:C10 000 and 20X1:C20 000)
- Information relating to property, plant and equipment

	20X0	20X1	20X2	20X3
Carrying amount	70 000	64 000	48 000	36 000
Tax base	90 000	70 000	50 000	30 000

- There are no other temporary or permanent differences other than those referred to above.
- There is insufficient evidence for Reflection Limited to realise deferred tax assets.
- The tax rate is constant at 30% and dividend income is taxed at 10%.

Required:

a) Prepare a current normal tax computation and deferred tax calculation.

b) Prepare the tax-related journals for the years ended 31 December 20X1, 20X2 and 20X3.

c) Prepare the tax expense and deferred tax note for the years ended 31 December 20X1, 20X2 and 20X3.

Question 6.17

Beans Limited a listed company manufacturing coffee. Their financial results for the year ending 20X3 are:

- Loss before tax is C20 000 in 20X3 and 20X2: C10 000. Profit before tax is C10 000 in 20X1.
- Dividend income received during the year was C20 000 (20X2:C20 000, 20X1:C20 000).
- An assessed loss of C100 000 is carried forward from 20X0.
- There are no other temporary or permanent differences other than those referred to above.
- Sufficient appropriate evidence was available to recognise deferred tax assets in 20X1. In 20X2, however, it did not appear probable that the tax loss would be able to be utilised. In 20X3 evidence was once again available to recognise deferred tax assets in full.
- The tax rate is constant at 30% whereas dividend income is taxable at 10%.

Assume that tax on dividend income can not be adjusted against unused tax losses and unused tax credits.

Required:

a) Prepare a current normal tax computation and deferred tax calculation.

b) Prepare the tax-related journals for the years ended 31 December 20X1, 20X2 and 20X3.

c) Prepare the tax expense and deferred tax note for the years ended 31 December 20X1, 20X2 and 20X3.

Question 6.18

Avi Limited operates in the food industry. It commenced operations on 1 January 20X6. The following information is available for its year ended 31 December 20X8:

- Profit before tax for the year ended 31 December 20X8 is C650 000. This is arrived at after correctly taking into account all the information below.
- The tax assessment for 20X7 arrived during 20X8 and indicated taxable profits of C650 000. Current normal tax of C195 000 was processed in 20X7.

- A building was sold for C100 000. It was purchased for C200 000. On the date of sale, 1 January 20X8, the building had a carrying amount of C120 000 and a tax base of C130 000.

- Plant was revalued to a fair value of C60 000 on 1 January 20X8. This is the first revaluation of any item of property, plant and equipment to date. The plant originally cost C100 000 and had a carrying amount on 1 January 20X8 of C50 000.

- No transfers of the realized portion of the revaluation surplus to retained earnings are made.

- No other items of property, plant and equipment were revalued.

- Depreciation is provided on the revalued property, plant and equipment. It had a remaining useful life of 5 years on 1 January 20X8 (consistent with previous estimates of useful life).

- The tax authorities allows tax depreciation on the item of plant (revalued above) at 25% p.a. on cost, but the item of plant already had a tax base of zero on 1 January 20X8.

- Depreciation and capital allowances on all items of property, plant and equipment (other than the revalued plant) were C50 000 and C35 000 respectively.

- Dividend income of C20 000 was earned in the current year.

- The following items appeared in the draft 31 December 20X8 statement of financial position:

  - accrued income (taxed when earned) C10 000
  - expenses prepaid (deductible when paid) C30 000

- The following items appeared on the 31 December 20X7 statement of financial position:

  - accrued income (taxed when earned) C20 000
  - expenses prepaid (deductible when paid) C0
  - property, plant and equipment (including plant and buildings) C700 000

- Property, plant and equipment (including plant and buildings) had a tax base at 31 December 20X7 of C680 000.

- The current normal tax rate is 30% (20X7: 29%) where as dividend income is taxable at 10%.

- There are no permanent or temporary differences other than those evident from the information provided.

Required:

a) Calculate the deferred tax balance at 31 December 20X8 using the balance sheet approach.

b) Calculate the current tax expense for the year ended 31 December 20X8

Question 6.19

The following is the trial balance of ABC Limited at 31 December 20X4:

TRIAL BALANCE AS AT 31 DECEMBER 20X4	
	Dr/ (Cr)
Revenue from services	(1 510 000)
Dividend income	(5 000)
Profit on sale of plant (carrying amount: 30 000 on date of sale)	(25 000)
Depreciation on plant	50 000
Donations made (not deductible)	25 000
Finance charges (deductible)	55 000
Other expenses (deductible)	600 000
Dividends declared	10 000
Revenue received in advance: 1 Jan X4 (taxable in 20X3)	(5 000)
Rent expense prepaid: 1 Jan X4 (deductible for tax purposes in 20X3)	20 000
Share capital	(200 000)
Retained earnings: 1 Jan X4	(320 000)
Total non-current liabilities (including deferred tax liability)	(150 000)
Property, plant and equipment	1 075 000
Inventory	400 000
Debtors	30 000
Creditors	(40 000)
Bank overdraft	(10 000)
	0

The trial balance was given to you by the director of ABC Limited. He studied accounting at university twenty years ago and received a first in Accounting 101. When his accountant threatened to resign two weeks ago due to low pay, he accepted the resignation thinking that he would be able to process the outstanding journal entries himself.

Looking at the material he found in the accountant's office after he had packed up and left the building, he discovered that things seemed to be a lot more involved than in Accounting 101, which was essentially focussed on basic book-keeping. He has requested you to resolve this crisis for him since he has to have the draft financial statements ready for a directors' meeting in an hour.

The following information is relevant:

- Revenue from services includes revenue received in advance at 31 December 20X4 is C15 000 (this is taxable in 20X4).
- Rent expense includes rent expense prepaid at 31 December 20X4 C30 000 (this is deductible for tax purposes in 20X4).
- The taxable capital gain on the sale of plant is C7 500 and the original cost of Plant is C 50 000.
- Tax depreciation granted as a deduction in 20X4 is C30 000.
- The tax base of property, plant and equipment was C800 000 at 31 December 20X4.

- Dividend of C30 000 were declared during 20X4 (C10 000 as an interim and C20 000 as a final dividend).
- The final dividend has not yet been journalised.
- Current normal tax in 20X3 was recognised at C110 000. The tax assessment of 20X3, received during late 20X4, indicated total assessed normal tax of C120 000.
- There was no movement in share capital during 20X4.
- The rate of normal tax is 40% (20X3: 30%) and dividend is taxed @ 10%.
- No journal entries relating to tax have yet been processed.

Required:

Process any outstanding journal entries for the year ended 31 December 20X4 (closing entries are not required).

Question 6.20

Sozorsted Limited is a company that specializes in luxury bedding, including mattresses, duvets, bed linen and pillows. It even offers a sleep clinic for customers wishing to have sleep disorders diagnosed.

You are at a dinner party, where the accountant of Sozorsted Limited confesses to you that he has been battling with their company tax calculations for a few days now and has asked you to please take a look at the information he has been working with.

SOZORSTED LIMITED
TRIAL BALANCE AS AT 31 DECEMBER 20X4

		Debit	Credit
Revenue from services			1 510 000
Dividend income			5 000
Profit on sale of plant	(carrying amount: C30 000 on date of sale)		25 000
Depreciation on plant		50 000	
Donations made	(not deductible for tax purposes)	25 000	
Finance charges	(deductible for tax purposes)	55 000	
Other expenses	(deductible for tax purposes)	600 000	
Dividends declared		10 000	
Revenue received in advance: 1/1/X4	(taxable in 20X3)		5 000
Rent expense prepaid: 1/1/X4	(deductible for tax purposes in 20X3)	20 000	
Share capital			200 000
Retained earnings: 1/1/X4			320 000
Total non-current liabilities	(including deferred tax liability)		150 000
Property, plant and equipment		1 075 000	
Inventory		400 000	
Debtors		30 000	
Creditors			40 000
Bank overdraft			10 000
		2 265 000	2 265 000

The following information is relevant:

- Revenue from services received in advance at 31 December 20X4 is C15 000 (this is taxable in 20X4).
- Rent expense prepaid at 31 December 20X4 is C30 000 (this is deductible for tax purposes in 20X4).
- The tax base of the plant on date of sale was C10 000.
- Tax depreciation on plant granted as a deduction in 20X4 is C30 000.
- The tax base of property, plant and equipment was C800 000 at 31 December 20X4.
- There was no movement in property, plant and equipment during 20X4 other than is evident from the information provided.
- There was no movement in share capital during 20X4.
- Dividends of C30 000 were declared during 20X4 (C10 000 was declared ion 15 May 20X4 as an interim dividend and C20 000 was declared on 29 December 20X4 as a final dividend).
- The final dividend has not yet been journalized.
- Current normal tax in 20X3 was recognized at C110 000. The tax assessment of 20X3, received during late 20X4, indicated total assessed normal tax of C120 000.
- The rate of normal tax is 30% (20X3: 40%).
- No journal entries relating to tax have yet been processed.
- Apart from any deferred tax liabilities, the only other non-current liability is a long-term loan.
- There are no temporary or permanent differences other that those evident from the information provided.
- There are no items of other comprehensive income in 20X4.

Required:

Disclose the above information in the financial statements of Sozorsted Limited for the year ended 31 December 20X4 in accordance with IFRSs. Only the following notes are required:

- Taxation
- Deferred tax

Comparatives are only required for the deferred tax note.

Chapter 7
Accounting policies, changes in accounting estimates and errors

Question	Key issues
7.1	Basic understanding of a change in estimate; a change in policy and errors
7.2	Discussion of a change in estimate vs a change in policy
7.3	Change in estimated useful life of equipment; using the re-allocation method: a) Disclosure b) Journal entries
7.4	Change in estimated residual values; using the re-allocation method: disclosure and journals a) residual value decreased b) residual value increased c) residual value increased above carrying amount
7.5	Change in estimated useful life, method and residual value of plant; using the re-allocation method; showing the tax effects: disclosure
7.6	Change in estimated useful life of vehicles; showing the tax effects; full disclosure (including statement of financial position)
7.7	Correction of error made in a prior year (tax authorities will re-open prior tax assessments); disclosure
7.8	a) and b): correction of error: measurement of inventory (tax authorities will re-open the relevant tax assessments) c): change in accounting policy: measurement of inventory (tax authorities will re-open the relevant tax assessments)
7.9	Correction of error made in a prior year, current tax and deferred tax computation, disclosure (no need to re-open any tax assessment)
7.10	Correction of an error made in a prior year, a correction of an error made in the current year and a change in accounting estimate (tax authorities will re-open any affected tax assessment)
7.11	Correction of error: disclosure and correcting journals (no need to re-open any tax assessment)
7.12	Correction of error: comparison of entries if error discovered in year when made or in subsequent year

Question 7.1

"The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors." (IAS 8, p1).

Required

a) i) Define an accounting policy.
   ii) Explain how to account for a change in accounting policy.

b) i) Define an accounting estimate.
   ii) Explain how to account for is a change in accounting estimate.

c) i) Define an error.
   ii) What errors are covered by IAS 8?
   iii) Explain how to account for an error.

Question 7.2

"A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate." (IAS 8, p35).

Required

a) Explain the accounting treatment for a change from the residual balance method of depreciation to the straight line method of depreciation.

b) Explain the accounting treatment for a change from the weighted average method to a FIFO (first-in first-out) method for valuing the cost of inventory.

Question 7.3

Col Mustard is the managing director of Cluedo Limited, a company specialising in solving murders. Cluedo Limited owns a large amount of very costly forensic equipment.

- The forensic equipment was purchased on 1 April 20X1, at a cost of C600 000.
- At that time it was determined that the equipment would be depreciated on a straight line basis over a period of 6 years, which is consistent with the tax depreciation allowance granted by the tax authorities.
- On 1 April 20X3, the total life of the forensic equipment was re-estimated to be 10 years. Cluedo Limited decided to adjust their records accordingly (using the re-allocation method).
- The tax rate has remained 30% since the company's inception.

Required:

a) Show how the above-mentioned information would be disclosed in the notes to the financial statements of Cluedo Limited for the year ended 31 March 20X4.

Accounting policies are required.

Comparatives are required.

b) Show the depreciation journal entries necessary from the information provided above, assuming:

i. Depreciation had not yet been processed for the year ended 31 March 20X4;
ii. Depreciation based on the old estimate had already been processed for the year ended 31 March 20X4.

c) Calculate the tax effect and journalise the related tax adjustment for the year ended 31 March 20X4.

Question 7.4

Dreamcoat Limited purchased a vehicle for C 10,000 on 1 January 20X0, on which date:

- the vehicle's residual value was estimated at C 1,000;
- the useful life of the vehicle was expected to be 10 years.

Dreamcoat Limited uses the reallocation method to record changes in accounting estimates.

Required:

Using the reallocation method and assuming:

a) the estimated residual value decreased to C 600 during 20X6:

i. disclose the 'change in estimate' note and the separately disclosable item: depreciation, for the year ended 31 December 20X6;
ii. provide the journal entries necessary assuming that depreciation had *not yet* been processed in the financial records for 20X6;
iii. provide the journal entries necessary assuming that depreciation based on the old estimate had *already* been processed in the financial records for 20X6.

b) the estimated residual value increased to C 1,500 during 20X6:

i. disclose the 'change in estimate' note and the separately disclosable item: depreciation, for the year ended 31 December 20X6;
ii. provide the journal entries necessary assuming that depreciation had not yet been processed in the financial records for 20X6;
iii. provide the journal entries necessary assuming that depreciation based on the old estimate had already been processed in the financial records for 20X6.

c) the estimated residual value increased to C 5,000 during 20X6:

i. disclose the 'change in estimate' note and the separately disclosable item: depreciation, for the year ended 31 December 20X6;
ii. provide the journal entries necessary assuming that depreciation had not yet been processed in the financial records for 20X6;
iii. provide the journal entries necessary assuming that depreciation based on the old estimate had already been processed in the financial records for 20X6.

Question 7.5

On 1 January 20X3 Meridian Limited purchased a plant for C 500,000. The company used the reducing balance method for calculating depreciation at a rate of 20% per annum. The tax authority grants a 40:20:20:20 allowance over four years.

During 20X6 the directors decided it was necessary to change to the straight line method of calculating depreciation for plant. It was agreed that the remaining estimated life of the plant was 3 years and the estimated residual value C 16,000 (previously this was nil).

This is considered to be a change in accounting estimate.

Meridian accounts for changes in estimates using the *re-allocation method.*

The company does not earn dividend income.

The draft statement of comprehensive income and statement of changes in equity had been prepared for the year ended 31 December by the bookkeeper who had *not* been advised of the directors' decision.

MERIDIAN LIMITED
DRAFT STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X6

	20X6 C	20X5 C
Revenue	800,000	650,000
Profit before depreciation	380,200	300,000
Depreciation – plant	(51,200)	(64,000)
Profit before tax	329,000	236,000
Income tax expense	(131,600)	(94,400)
Normal: current	112,080	80,000
Normal: deferred	19,520	14,400
Profit for the period	197,400	141,600
Other comprehensive income	0	0
Total comprehensive income	197,400	141,600

MERIDIAN LIMITED
DRAFT STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X6

	Retained earnings
	C
Balance: 1 January 20X5	(40,000)
Total comprehensive income	140,350
Dividends	(10,000)
Balance: 31 December 20X5	90,350
Total comprehensive income	197,400
Dividends	(15,000)
Balance: 31 December 20X6	272,750

The tax rate has remained constant at 40%.

Required:

Prepare the statement of comprehensive income and relevant extracts from the statement of changes in equity of Meridian Limited for the year ended 31 December 20X6, in compliance with International Financial Reporting Standards.

Provide only the accounting policies, profit before tax, taxation and change in estimate notes to the financial statements.

Comparatives are required.

Question 7.6

Mild Limited owns vehicles (its only item of property, plant and equipment) with the following original details:

Cost	C 600,000
Purchase date	1/1/20X2
Estimated useful life (estimated on date of purchase)	8 years
Depreciation to nil residual value	Straight-line

- On 1 January 20X5, the total estimated useful life was revised to 6 years.
- The company uses the re-allocation method to account for changes in estimates.

You are given the following statement of comprehensive income for the year ended 31 December 20X5, drafted *before* adjusting for the effects of the change in estimate:

MILD LIMITED
DRAFT STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X5

	20X5	20X4
	C	C
Profit before taxation	500,000	650,000
Income tax expense	(180,000)	(300,000)
Profit for the period	320,000	350,000
Other comprehensive income	0	0
Total comprehensive income	320,000	350,000

The corporate tax rate is 30%.

Required:

a) Prepare the necessary journal entries assuming that depreciation had already been processed in the 20X5 accounting records based on the old estimate.

b) Prepare the notes to the financial statements of Mild Limited for the year ended 31 December 20X5 in accordance with International Financial Reporting Standards.

Accounting policies are required.

c) Prepare the statement of comprehensive income of Mild Limited for the year ended 31 December 20X5 in accordance with International Financial Reporting Standards
Notes are not required.

d) Disclose property, plant and equipment in the statement of financial position of Mild Limited as at 31 December 20X5 in accordance with International Financial Reporting Standards

Notes are not required.

Question 7.7

Pear Limited is a small company involved in the car-hire industry. It owns a fleet of cars, from small hatchbacks to luxury 4 X 4's. The company has links to a major airline whereby clients can reserve their car at the same time as booking their airline ticket.

Additional information:

- The company acquired a luxury 4 X 4 vehicle on 2 January 20X3 at a cost of C 600,000. The vehicle has a useful life of four years with no residual value.

- During the year ended 31 December 20X6, it was discovered that the cost of the 4 X 4 vehicle was expensed on acquisition.

- The expense was incorrectly claimed as a deduction in 20X3. The tax authorities allow a tax allowance on vehicles at 25% per annum on the straight line basis. The allowance has not been claimed since 20X3 and the tax authorities are permitting the assessments for the prior years to be reopened.

- No entries have been made in the accounting records relating to this vehicle during the current year.

- The corporate tax rate is 29% and has not changed since the vehicle was acquired.

The trial balances of Pear Limited at 31 December 20X5 and 20X6 are shown below:

	20X6		20X5	
	Debit	**Credit**	**Debit**	**Credit**
Motor vehicles	3,000,000		3,250,000	
Accounts receivable	360,000		310,000	
Bank	75,000			429,000
Accounts payable		110,000		190,000
Current tax payable		145,000		116,000
Ordinary share capital		2,700,000		2,700,000
Retained earnings (at beginning of year)		125,000	159,000	
Profit before tax		500,000		400,000
Taxation	145,000		116,000	
	3,580,000	3,580.000	3,835,000	3,835,000

Required:

a) Prepare relevant extracts from the statement of comprehensive income and prepare the retained earnings column of the statement of changes of equity of Pear Limited for the year ended 31 December 20X6.

b) Prepare the correction of error note to the financial statements at 31 December 20X6.

Question 7.8

Hot Ltd has recently discovered that inventory has been incorrectly valued using the weighted average method (WA) instead of the first-in-first-out method (FIFO) for the past four years.

The effect of this error is as follows:

Year-end inventory balances	**20X7**	**20X6**	**20X5**	**20X4**
	C	**C**	**C**	**C**
WA method (did use)	15,000	14,000	12,000	10,000
FIFO method (should have used)	18,000	15,000	14,000	11,000

The draft financial statements *before* correcting this error are as follows:

HOT LIMITED
DRAFT STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X7

	20X7	**20X6**
	C	**C**
Revenue	1,200,000	900,000
Cost of sales	(420,000)	(350,000)
Gross profit	780,000	550,000
Other costs	(220,000)	(200,000)
Profit before tax	560,000	350,000
Income tax expense	(235,200)	(136,500)
Profit for the period	324,800	213,500
Other comprehensive income	0	0
Total comprehensive income	324,800	213,500

HOT LIMITED
DRAFT STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X7

	Retained earnings
	C
Opening balance: 1/1/20X6	67 500
Total comprehensive income: 20X6	213 500
Closing balance: 31/12/20X6	281 000
Total comprehensive income: 20X7	324 800
Closing balance: 31/12/20X7	605 800

The error is considered to be material.

The tax authorities will be re-opening the tax assessments for all year/s affected. The normal income tax rate is levied at 30%.

Required:

a) Prepare the journal entry that needs to be processed in the 20X7 financial year to correct the error.

b) Prepare the statement of comprehensive income, statement of changes in equity, statement of financial position and notes of Hot Ltd for the year ended 31 December 20X7, in accordance with International Financial Reporting Standards.

c) Repeat part (b) above assuming that an error was not made but rather that the company changed its accounting policy: the company previously used the weighted average method when recording inventory movements and decided to change this policy to the first-in-first-out method.

Accounting policies are required.

The notes that purely support the statement of financial position are not required.

Ignore earnings per share.

Question 7.9

Oranges Ltd is a company operating in the entertainment industry. The following draft extracts of the statement of comprehensive income and statement of financial position have been presented to you together with additional information that has not yet been taken into account in the preparation thereof:

ORANGES LTD
DRAFT EXTRACTS FROM STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X3

	20X3	20X2
	C	C
Profit before tax	300 000	250 000
Income tax expense	(80 000)	(70 000)
Profit for the period	220 000	180 000
Other comprehensive income	0	0
Total comprehensive income	220 000	180 000

ORANGES LTD
DRAFT EXTRACTS STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 20X3

	20X3	20X2	20X1
	C	C	C
Property, plant and equipment	1,217,000	1,391,500	1,566,000
- Machinery carrying amount	152,000	176,500	201,000
- Equipment carrying amount	1,065,000	1,215,000	1,365,000
Retained earnings	?	?	1,000,000
Deferred tax liability	140,000	150,000	170,000

Additional information:

Machinery:

- During 20X3, the company changed the estimated residual value of its machinery from C 5,000 to C 10,000 and changed the total expected useful life of machinery from 10 years to 15 years. The machinery had all been purchased on 1 January 20X0 at a cost of C 250,000. Depreciation is provided on the straight line method.

Equipment:

- During 20X3, it was discovered that the cost of an item of inventory sold on 1 July 20X1 (cost: C 300,000), had been incorrectly debited to equipment. The taxable profit and tax base were correctly calculated in all years affected.

- The cost of equipment was otherwise C 1,200,000, all having been purchased on 1 January 20X0.

- The company depreciates equipment at 10% per annum to nil residual values (apportioned for part of a year where appropriate) using the straight-line basis.

Other general information:

- The opening retained earnings as at 1 January 20X2 was C 1,000,000. There were no dividend declarations or transfers to or from retained earnings during 20X2 and 20X3.

- There was no other movement in property, plant and equipment other than that which is evident from the information provided. Other than the incorrect debit, all movements in the carrying amount of property, plant and equipment since date of purchase relate to depreciation.

- All amounts are considered to be material.

- The normal income tax rate is 30%.

Required:

a) Calculate the effect of the change in estimate using the re-allocation method. *Detailed* workings are required.

b) Disclose the following:

- the change in estimate note;
- the correction of error note
- the statement of comprehensive income;
- the retained earnings in the statement of changes in equity; and
- the statement of financial position for the year ended as at 31 December 20X3 in conformity with IFRSs.

Accounting policies are not required.

Comparatives are required.

c) Show all the journal entries that would need to be processed to effect:

- the change in accounting estimate; and
- the correction of the error.

Assume that the adjustments may only be posted in 20X3.

Question 7.10

The following draft financial statements relate to Truth Limited:

TRUTH LIMITED
DRAFT STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X6

	20X6 C	20X5 C
Revenue	3 810 000	2 600 000
Cost of sales	(2 280 000)	(1 160 000)
Gross profit	1 530 000	1 440 000
Other income	250 000	100 000
Other costs	(890 000)	(750 000)
Profit before taxation	890 000	790 000
Income tax expense	(252 000)	(207 000)
Profit for the period	638 000	583 000
Other comprehensive income	0	0
Total comprehensive income	638 000	583 000

TRUTH LIMITED
DRAFT STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X6

	Retained earnings C
Balance – 1 January 20X5	900 000
Total comprehensive income – 20X5	583 000
Balance – 31 December 20X5	1 483 000
Total comprehensive income – 20X6	638 000
Balance – 31 December 20X6	2 121 000

Additional information:

- Included in 'other income' are the following

	20X6	20X5
	C	C
Dividend income (exempt)	100 000	100 000
Profit on expropriation of land (exempt)	150 000	0

The capital gain on the expropriation of land, as calculated in terms of the capital gains tax legislation, was zero. There were no tax allowances on the land.

- Included in 'other costs' are the following items:

	20X6	20X5
	C	C
Loss of inventory (see below)	130 000	0
Directors remuneration	150 000	150 000
Depreciation on machinery (see below)	143 750	100 000
Depreciation on vehicles (see below)	30 000	30 000
Loss on sale of land (not deductible)	200 000	0

- The inventory was destroyed in a tornado. The inventory was not insured. The loss is tax deductible.

- The bookkeeper erroneously capitalised advertising expense amounting to C 750 000 to the *machinery* account on 1 June 20X6. All machinery was purchased on 1 May 20X4 at a cost of C 1 000 000. Depreciation on machinery is calculated at 10% per annum on the straight-line basis to nil residual values. The bookkeeper has not yet corrected this error. The same error had been made when calculating the tax base and taxable profit for the year. Machinery is used in the manufacture of inventory. There was no inventory on hand at year end.

- During 20X6, it was decided to change the rate of depreciation on *vehicles* from straight-line over 10 years to straight-line over 5 years (in both cases, to nil residual values). All vehicles were purchased on 1 July 20X3 at a cost of C 300 000. This change has not yet been accounted for. The company uses the re-allocation method to adjust for changes in estimates. The vehicles are used to deliver inventory to customers.

- On receipt of the 20X5 tax assessment, it was discovered that the bookkeeper had erroneously included VAT of C 300 000 in revenue in 20X5 and that, as a result, the current tax in 20X5 had been incorrectly estimated by the accountant. The bookkeeper has not yet corrected the error. The tax authorities will re-open the tax assessment.

- The tax authorities allow tax depreciation as follows:

  - machinery: 20% per annum straight-line (apportioned for part of a year)
  - vehicles: 20% per annum straight-line (not apportioned for parts of a year)

- The normal corporate tax rate remained constant at 30%

- There are no other temporary differences other than those indicated by the information presented.

- All amounts are considered to be material.

Required:

a) Prepare all journal entries necessary from the information presented above.

b) Prepare the statement of comprehensive income, statement of changes in equity and related notes of Truth Limited for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards. Accounting policies are *not* required.

Question 7.11

Autumn Ltd manufactures slot machines for the gaming industry. On 1 January 20X1, Autumn Ltd bought the rights to manufacture 'Guppy' slot machines at a cost of C 600 000. The cost was recognized as an intangible asset and was amortised over its expected finite life of 20 years to a nil residual value using the straight-line method.

During 20X4 it was discovered, however, that Autumn Ltd had purchased the legal rights for a period of only 15 years. The effect of this information is considered to be material. The tax authority allows Autumn Ltd to deduct the cost of the rights over a period of 10 years on the straight-line method.

The following is an extract of the draft statement of changes in equity for the year ended 31 December 20X4, before making any necessary corrections.

AUTUMN LIMITED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20X4	**Retained earnings**
	C
Balance: 1 January 20X3	800 000
Total comprehensive income: 20X3	270 000
Balance: 1 January 20X4	1 070 000
Total comprehensive income: 20X4	370 000
Balance: 31 December 20X4	1 440 000

There are no components of other comprehensive income.

The normal tax rate has remained 30% since inception of the company.

Required:

a) Show the correcting journal entries.

b) Disclose the following in the financial statements of Autumn Ltd for the year ended 31 December 20X4 in accordance with International Financial Reporting Standards:

   i. Correction of error note;
   ii. Statement of changes in equity; and
   iii. Statement of financial position.

Question 7.12

Truthful Limited is a company operating in the engineering sector. The company purchased its only item of equipment on 2 January 20X1 at a cost of C 100 000.

During the 20X2 financial year, it was discovered that the equipment purchased in January 20X1 was recorded as a repair expense.

The profit before depreciation and repair expenses for the 20X1 financial year amounted to C 2 000 000.

The corporate tax rate is 30%.

Part A
The company provides for depreciation at *10% per annum* on the straight-line basis. The tax authorities allow a tax depreciation allowance of *20% per annum*, also on the straight-line basis.

The incorrect information was also submitted to the tax authorities.

Required:

a) Prepare the correcting journal entries that are processed in the year 20X2.

b) Prepare the correcting journal entries that would have been processed if the error was discovered at the end of the 20X1 year.

Part B
Same information as in part A, except

- The company provides for depreciation at *10% per annum* on the straight-line basis. The tax authorities allow a tax depreciation allowance of *10% per annum*, also on the straight-line basis.

Required:

a) Prepare the correcting journal entries that are processed in the year 20X2.

b) Prepare the correcting journal entries that would have been processed if the error was discovered at the end of the year 20X1.

Part C
Same information as in part A, except

- The company provides for depreciation at *10% per annum* on the straight-line basis. The tax authorities allow a tax depreciation allowance of *10% per annum*, also on the straight-line basis.

- The *correct* information was submitted to the tax authorities.

Required:

a) Prepare the correcting journal entries that are processed in the year 20X2.

b) Prepare the correcting journal entries that would have been processed if the error was discovered at the end of the year 20X1.

Part 2

Chapter 8
Earnings per share

Question	Key issues
Section A: Basic and Headline Earnings per share	
8.1	Understanding EPS relating to share issues not for value / capital profits, earnings compared to dividends
8.2	Share issue for cash followed by capitalization issue, arrear preference dividends
8.3	Basic EPS / DPS, share issue for cash
8.4	Basic EPS, capitalization issue
8.5	Basic EPS / DPS, share split
8.6	Basic EPS, rights issue (i.e. less than market value)
8.7	Basic EPS, issue at market value, rights issue (i.e. less than market value), share split: disclosure over 3 years
8.8	Basic EPS, issue at market value, rights issue, capitalization issue: disclosure over 3 years and journals
8.9	Basic EPS / DPS for ordinary and participating preference shares, rights issue
8.10	Basic EPS, with an error and a share split
8.11	Basic EPS, with a capitalization issue, share consolidation
Section B: Basic and Diluted Earnings per share	
8.12	Basic and diluted earnings per share: convertible debentures
8.13	Basic and diluted earnings per share: options and a share issue
8.14	Basic and diluted earnings per share: convertible debentures and a rights issue
8.15	Basic and diluted earnings per share: convertible preference shares and options, with a rights issue
8.16	Basic and diluted earnings per share: convertible preference shares and options, with a rights issue and discontinued operation.
8.17	Basic and diluted earnings per share: convertible preference shares and options, with a rights issue, anti-dilution and discontinued operation.
8.18	Basic and diluted earnings per share
8.19	Basic and diluted earnings per share

Question 8.1

You have recently been appointed the accountant of Cleopatra Pet Products Limited. Your first assignment was to draw up the financial statements of the company for the year ended 30 September 20X4. This you have done, including earnings and dividends per share.

The Managing Director, instead of praising you for your technical expertise as you expected, wants to know why you changed last year's number of shares when calculating the earnings per share for the comparative statement of comprehensive income. He points out accusingly that last year's statement of financial position reflects only 100 000 ordinary shares and that the 200 000 shares that you have reflected have only been in issue since half-way through the current year. Furthermore, he wants to know why you included the profit of C80 000 made on the sale of investments during the year. He believes that this should be excluded.

Required:

a) Explain to the managing director all the circumstances under which the previous year's comparative figures for earnings per share should be restated. Give reasons why the restatement is necessary in each case.

b) Explain why the profit on the sale of investments was included in the amount of earnings used for the earnings per share calculation.

c) Explain why the earnings per share figure is a better indicator of performance than

- dividends per share
- profit after tax

Question 8.2

Aussie Limited was incorporated in 20X0 with an issued share capital of 150 000 9% cumulative preference shares of C1 each and 150 000 12% non-cumulative preference shares of C1 each and 300 000 ordinary shares of C1 each. The preference shares are non-redeemable. The only changes to this structure were a new issue of 50 000 ordinary shares at a fair value of C1.50 on 1 January 20X2 and a capitalisation issue of 1 share for every 5 held on 15 June 20X3.

The abridged statement of comprehensive income and statement of changes in equity of the company for the years ended 30 September 20X2 and 20X3 are as follows:

AUSSIE LIMITED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER	**20X3**	**20X2**
	C	C
Profit after tax	500 000	10 000
Minority interest	(25 000)	(20 000)
Profit for the period	475 000	(10 000)
Other comprehensive income	0	0
Total comprehensive income	475 000	(10 000)

AUSSIE LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 SEPTEMBER

	Retained earnings	
	20X3	**20X2**
	C	**C**
Opening balance	940 000	950 000
Total comprehensive income	475 000	(10 000)
Capitalisation issue of ordinary shares	(70 000)	0
Dividends paid - 30 Sept 20X3	(150 000)	0
Ordinary shares	105 000	0
9% preference shares	27 000	0
12% preference shares	18 000	0
Closing balance	1 195 000	940 000

The profit before tax in 20X2 includes a profit on disposal of land of C50 000.

The profit before tax in 20X3 includes a loss on sale of land of C70 000. This loss may be deducted from future capital gains in order to reduce future tax. At the end of 20X3, the company did not expect any future capital profits and therefore no deferred tax was provided on the capital loss of C70 000.

There are no components of other comprehensive income.

The normal tax rate for both years was 29%.

Required:

Calculate the earnings per share and dividends per share and show how they would be disclosed in the financial statements of Aussie Limited for the year ended 30 September 20X3 in accordance with International Financial Reporting Standards.

Comparatives and notes to EPS required.

Question 8.3

The following information relates to Mitch Limited for the year ended 31 December 20X1:

MITCH LIMITED
EXTRACTS FROM PRE-ADJUSTMENT TRIAL BALANCE AT 31 DECEMBER 20X1

	20X1	**20X0**
	Debit/(Credit)	**Debit/(Credit)**
Profit for the period	(100 000)	(80 000)
Preference dividend declared – 31/12	5 000	5 000
Ordinary dividend declared – 31/12	10 000	6 000

Share capital details are as follows:

- Ordinary share capital balance at 1/1/20X0: C200 000 (C0.20 par value)
- 10% non-cumulative non-redeemable preference shares balance at 1/1/20X0: C50 000 (C1 par value)
- 500 000 ordinary shares were issued on 31/3/20X1at the market value of C0.20 per share.
- There are no components of other comprehensive income.

Required:

Prepare extracts from the statement of comprehensive income and statement of changes in equity of Mitch Limited for the year ended 31 December 20X1 in terms of International Financial Reporting Standards.

Comparatives are required

Only the notes relating to EPS are required.

Question 8.4

The following information relates to Miles Limited for the year ended 31 December 20X1:

MILES LIMITED
DRAFT RESULTS OF OPERATIONS

	20X1	20X0
	C	C
Profit before tax	503 000	403 000
Income tax expense	(200 000)	(180 000)
Profit after tax	303 000	223 000
Preference dividends declared	(3 000)	(3 000)
Ordinary dividend declared	(30 000)	(30 000)
Retained earnings for the year	270 000	190 000

Additional information:

- The balances in equity at 1 January 20X0 comprised:
  - 1 000 000 ordinary shares of C0.20 each;
  - 10 000 10% non-cumulative non-redeemable preference shares of C3 each;
  - Share premium of C290 000; and
  - Retained earnings of C60 000.
- In terms of an agreement with the bank the company has undertaken to have a capitalisation issue in order to capitalise excess reserves. In accordance with this agreement, there was a capitalisation issue of 1 for every 2 shares held on 1 July 20X1.
- There are no components of other comprehensive income.

Required:

Prepare extracts from the statement of comprehensive income, statement of changes in equity and related notes of Miles Limited in terms of International Financial Reporting Standards for the year ended 31 December 20X1.

Comparatives are required.

Question 8.5

LOYAL LIMITED
EXTRACTS FROM PRE-ADJUSTMENT TRIAL BALANCE
AT 31 DECEMBER

	20X1 Debit/(Credit)	20X0 Debit/(Credit)
Profit for the period	(250 000)	(280 000)
Non-cumulative preference dividend paid 31/12/20X1	3 000	3 000
Ordinary dividend declared 31/12/20X1	10 000	12 000

Additional information:

- The balances in equity at 1 January 20X0 comprised:
  - 100 000 ordinary shares of C1 each.
  - 20 000 15% non-cumulative non-redeemable preference shares of C1 each.
  - Retained earnings of C120 000.
- There was a share split on 1/7/20X1 in which every 1 ordinary share became 2 shares.
- There are no components of other comprehensive income.

Required:

Prepare extracts from the statement of comprehensive income and statement of changes in equity of Loyal Limited in terms of International Financial Reporting Standards for the year ended 31 December 20X1.

Comparatives are required.

Only the earnings per share note is required.

Question 8.6

ROGER LIMITED
DRAFT RESULTS OF OPERATIONS
FOR THE YEAR ENDED 31 DECEMBER 20X8

	20X8	20X7
	C	C
Profit before tax	750 000	730 000
Income tax expense	(400 000)	(300 000)
Profit for the period	350 000	430 000
Ordinary dividend declared	(40 000)	(30 000)
Preference dividend declared	(32 000)	(32 000)
Retained earnings for the year	278 000	368 000
Retained earnings - beginning of the year	568 000	200 000
Retained earnings - end year	846 000	568 000

Additional information:

- The company's share capital at 31 December 20X8 was as follows:
  - C500 000 ordinary shares of par value of C0.50 each.
  - 200 000 8% non-cumulative non-redeemable preference shares of C2 each.
- On 30 September 20X8, the company announced a rights issue of 1 ordinary share for every 3 shares held at a price of C2.20. The market price at this date was C2,50. All the shareholders took up the offer on this date. Prior to this date all shares issued were issued at par value.
- There are no components of other comprehensive income.
- The normal tax rate for both years was 40%.

Required:

Prepare extracts from the statement of comprehensive income and statement of changes in equity of Roger Limited in terms of International Financial Reporting Standards for the year ended 31 December 20X8.

Comparatives and the earnings per share note are required.

Round off all earnings per share calculations to the nearest two decimal places.

Question 8.7

The following are the details of the share movements of a company called Anne Limited:

- There were 10 000 shares in issue throughout 20X0;
- 10 000 shares were issued on 30 June 20X1;
- 10 000 shares were issued on 30 September 20X2;

- There was a rights issue on 30 June 20X3, offering 2 shares for every 3 shares held on this date at a strike (issue) price of C10 each when the market price was C15/ share. All shares were taken up;

- Shares were split on 30 September 20X3 (splitting 2 shares into 3 shares).

- There were 100 000 C10, 20%, non-redeemable, non-cumulative preference shares (i.e. treated as equity) in issue throughout the three years. The preference dividends were declared in each of the three years.

Details of Anne Limited's profits are as follows:	**20X3**	**20X2**	**20X1**
• Profit for the year	700 000	900 000	800 000

There are no components of other comprehensive income.

The normal tax rate for both years was 40%.

Required:

Calculate and disclose earnings per share in the financial statements for the year ended:

a) 31 December 20X3
b) 31 December 20X2
c) 31 December 20X1 (no comparatives are required for part (c)).

Question 8.8

Thomas Limited was incorporated on 1 January 20X2. An extract of its ***previous*** year's statement of financial position follows:

EXTRACTS OF THE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20X3

	20X3	**20X2**
EQUITY	**C**	**C**
Ordinary share capital: C1 shares	270 000	100 000
Preference share capital: C2 shares	100 000	100 000
Share premium	30 000	10 000
Retained earnings	250 000	100 000

Information regarding its share capital:

Authorised share capital:
- 400 000 ordinary shares of C1 each; and
- 300 000 10% non-redeemable, non-cumulative preference shares of C2 each.

Preference share capital:
- 50 000 preference shares were issued on 1 January 20X2.
- Preference dividends are always declared and paid on 30 December of each year.

Ordinary share capital:
- 100 000 ordinary shares were issued on 1 January 20X2.
- 170 000 ordinary shares were issued on 30 June 20X3.

- 10 000 ordinary shares were offered to existing shareholders at C6 each on 30 May 20X4, when the market price was C9 each. All 10 000 shares offered were taken up on this day.
- On 30 November 20X4, there was a capitalisation issue of 2 ordinary shares for every 5 shares in issue. The capitalisation issue utilised the share premium as far as is possible. The directors agreed that the impact of the capitalisation issue on the retained earnings should be minimised as far as possible.

Other information:

- Share issue expenses were C15 000 during 20X4.
- The profit for 20X4 was C180 000, *20X3 was* C150 000 and 20X2 was C100 000.
- There are no other share issues or reserves other than those mentioned above.

Required:

a) Disclose earnings per share in the statement of comprehensive income and notes to the financial statements of Thomas Limited for the year ended 31 December 20X4, showing both 20X3 and 20X2 as comparatives.

b) Calculate the basic earnings per share as it would have been disclosed in the financial statements for the year ended 31 December 20X3.

c) Show all journal entries relating to the transactions mentioned above for the year ended 31 December 20X4

Question 8.9

MATTHEW LIMITED
EXTRACTS FROM PRE-ADJUSTMENT TRIAL BALANCE
AT 31 DECEMBER

	20X1	20X0
	C	C
Profit after tax	320 000	290 000
Fixed non-cumulative non-redeemable preference dividend paid – 31/12	4 500	4 500
Fixed non-cumulative non-redeemable participating preference dividend paid – 31/12	4 000	4 000
Ordinary dividend paid – 31/12	10 000	0

Additional information:

The following information was extracted from the statement of financial position and related notes:

	C
• Issued share capital consists of:	
• Ordinary shares of 0.70 par value: 1/1/20X1	700 000
• 5% non-cumulative non-redeemable preference shares of C1 each: 1/1/20X1	90 000
• 20% non-cumulative non-redeemable participating preference shares of C0.50 each: 1/1/20X1 (these shares participate to the extent of 2/5 of the ordinary dividend declared)	20 000

- There was a rights issue on 30/9/20X1, in terms of which, each ordinary shareholder was granted the right to purchase one share for every four shares held at par value. All the shares offered were taken up on that day. The market price on this day was C1.40 per share.

- There are no components of other comprehensive income.

Required:

Disclose the above, in accordance with International Financial Reporting Standards, in the financial statements for the year ended 31 December 20X1.

Question 8.10

Hubbard Limited's bookkeeper drew up the following draft statement of comprehensive income for the year:

HUBBARD LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 20X6

	20X6	20X5
	C	C
Sales	500 000	400 000
Cost of sales	(250 000)	(200 000)
Gross profit	250 000	200 000
Other expenses	(110 000)	(103 000)
Profit on sale of plant	7 000	0
Interest received	3 000	3 000
Profit before tax	150 000	100 000
Income tax expense – current	(40 000)	(35 000)
Profit for the period	110 000	65 000
Other comprehensive income	0	0
Total comprehensive income	110 000	65 000

The following are extracts from the draft statement of changes in equity for the year ended:

HUBBARD LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 20X6

	Retained earnings	
	20X6	20X5
	C	C
Opening balance	81 000	25 000
Total comprehensive income	110 000	65 000
Transfer to non-distributable reserves	(7 000)	0
Ordinary dividends	(10 000)	(5 000)
Preference dividends	(2 000)	(4 000)
Closing balance	172 000	81 000

Additional information

- Before the 20X6 financial statements were published, it was discovered that a deduction of C10 000 had been omitted from the 20X5 current tax calculation. The effect of the errors is material. All the information needed to report the correction of the error is available without undue cost or effort.

- The company had operated with an ordinary share capital of C100 000 (200 000 shares of C0.50 each) for a number of years. On 31 March 20X5, 50 000 new shares were issued at a premium of C0.10 each. On 1 January 20X6, the directors decided to split the share capital into shares of C0.25 in order to improve the shares' marketability.

- The dividends paid to the ordinary shareholders were declared as follows:

	20X6	20X5
31 December	4 000	-
30 June	6 000	5 000
	10 000	5 000

- The preference dividends in 20X5 include C2 000 dividends owing in respect of 20X4. A dividend was not declared in 20X4 as a loss was incurred in that year.

- There are no components of other comprehensive income.

- The normal tax rate for both years was 35%.

Required:

In so far as the information is available, prepare the statement of comprehensive income and statement of changes in equity of Hubbard Limited for the year ended 30 June 20X6 in terms of International Financial Reporting Standards.

Comparatives are required.

The only notes required are in respect of earnings per share and the error.

Question 8.11

Trini Limited operates in the retail sector and is listed on the KSE. The following extract of information is available for its financial year ended 31 December 20X8.

TRINI LIMITED **STATEMENT OF FINANCIAL POSITION** **FOR THE YEAR ENDED 31 DECEMBER 20X7**	**20X7**
	C
Equity and Liabilities	
Issued ordinary shares of C2 par value each	1 000 000
Share premium	200 000

The correctly calculated net profit after tax amounted to C3 220 000 for 20X8 (20X7: C2 125 000)

Additional information

- On 30 April 20X8, Trini Limited issued 125 000 shares at their market value of C5 per share. Another issue of 30 000 shares took place on 30 November 20X8 at their market value of C7 per share. A further issue of 30 000 shares took place on 20 January 20X9 at their market value of C7 per share.
- Trini limited had a rights issue on 30 May 20X8, the terms of which were as follows:
  - One share was offered at an exercise price of C3 for every 4 shares held on 30 May 20X8. the market price immediately before the issue was C5 per share. All shares offered were taken up.
- On 31 October 20X8, Trini Limited consolidated its shares such that every 5 shares were consolidated into 2 shares.
- An ordinary dividend of C275 000 on 30 December 20X8. On 29 December 20X7 the ordinary dividend declared was C200 000.
- There are no components of other comprehensive income.

***Required*:**

Disclose the earnings per share in the Statement of comprehensive income and in the related note to the financial statements of Trini Limited for the year ended 31 December 20X8 in accordance with IFRS.

Question 8.12

Sprog Limited had a profit for the year ended 20X5 of C20 000 000. Details regarding the company's share capital and potential share capital at 31 December 20X5 are overleaf:

- There are 1 000 000 000 authorised ordinary shares (with a par value of C4.50), of which 10% are in issue.
- There are 500 000 convertible debentures in issue. These debentures may be converted into ordinary shares in a ratio of 100 ordinary shares for every 1 debenture held, (at the option of the debenture holder), on the 31 December 20X8. Any debentures not converted at this date will be redeemed. Finance charges on these debentures of C1 505 000 were incurred during 20X5.
- There were no movements in share capital during 20X5.
- No dividends were declared in 20X5.
- There are no components of other comprehensive income.

Required:

Disclose earnings per share in Sprog Limited's statement of comprehensive income for the year ended 31 December 20X5.

Ignore tax.

Comparatives and notes to the financial statements are not required.

Question 8.13

Details of Laser Limited's profits (or losses) for 20X5 and 20X4 are as follows:

- Profit for the year: C125 000 (20X4: loss of 50 000).

Details of Laser Limited's share capital and potential share capital include the following:

- At 1 January 20X4 there were 100 000 ordinary shares with a par value of C1.75 in issue.
- On 30 November 20X4, 12 000 ordinary shares were issued at a premium of C0.25 per share. There have been no other issues since 30 November 20X4.
- There are 25 000 options in issue entitling the option holder to 1 ordinary share at a strike price of C2.00 per share, (the average market price of an ordinary share for 20X5: C2.75).

Other information includes:

- An interim ordinary dividend of C0.04 per share was declared and paid on the 30 June 20X5. On 15 December 20X5 a final ordinary dividend of C2 800 was declared.
- No dividends were declared in 20X4 due to the loss made in 20X4.
- Normal company tax is levied at 35%.
- There are no components of other comprehensive income.

Required:

Disclose earnings per share for the year ended 31 December 20X5 in the Laser Limited's statement of comprehensive income.

Notes to the financial statements are not required.

Question 8.14

Rebel Limited had the following *draft* statement of comprehensive income:

REBEL LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR YEAR ENDED 31 DECEMBER 20X5 (DRAFT)

	20X5 C	20X4 C
Basic earnings per share	0.20	1.75
Basic diluted earnings per share	0.20	1.75
Dividends per share	0.05	0.00

The financial accountant of Rebel Limited resigned shortly before year end, leaving the bookkeeper to draw up the draft annual financial statements. Numerous errors have been made by the bookkeeper. The errors are as follows:

- The preference shareholders receive a fixed dividend of C5 000 a year. This has been ignored in the calculation of earnings per share.

- During further investigations, the bookkeeper revealed that no additional work had been done for dilutive earnings per share as the bookkeeper was under the assumption that the calculations were highly complex and that in their small business the figures would be the same as basic earnings per share.

- In your investigations you came across the following working paper:

	Actual 20X5	Weighted 20X5	Adjusted 20X4
1 January	20 000	20 000	20 000
Rights issue: 'for value' portion	60 000	60 000	0
Sub-total	80 000	80 000	20 000
Rights issue: 'not for value' portion	20 000	20 000	0
31 December	100 000	100 000	20 000

At 1 January 20X4 there were 20 000 ordinary shares in issue. The rights issue (which took place on the 30 June 20X5) was on a '4 for 1' basis, at a strike price of C1.50 per share. The market value per share immediately before the rights issue was C2.00.

- The following potential ordinary shares are in issue: convertible debentures (convertible at the option of the debenture holders). These are convertible into 5 000 ordinary shares on 31 December 20X7. If not converted, the debentures will be redeemed on 31 December 20X7. Finance costs of C100 are incurred annually on these debentures. The convertible debentures were issued half way through 20X4.

- No dividends were declared in 20X4, but in the following financial year (early 20X5, before the financial statements were authorised and issued) a dividend of C0.03 per share was declared. Other dividend declarations in 20X5 included an interim dividend of C0.05 per share (declared in June 20X5) and a final dividend of C0.02 per share (declared in December 20X5).

Required:

Recalculate the correct earnings per share figures and disclose them in the statement of comprehensive income of Rebel Limited for the year ended 31 December 20X5.

Ignore tax. Notes are not required.

Question 8.15

The following relates to Dabchick Limited for the year ended 31 December 20X5:

- Profit for the year C200 000 (20X4: C135 000).

- On 1 January 20X4 there were 250 000 ordinary shares each with a par value of C5.00 in issue. On the 30 September 20X4 there was a rights issue on a basis of 1 ordinary share issued for every 5 already held at a price of C6.00. The market value of the ordinary shares immediately before the rights issue was C7.50 per share. On 31 May 20X5 there was an issue of 50 000 ordinary shares at market price (C5 per share).

- There are 25 000 options in existence, each of which allows the holder to acquire four shares at a strike price of C7.00 per share. The options have already vested but will only expire in many years to come. The average market price per ordinary share for 20X4 and 20X5 was C8.00. These options were in existence throughout 20X4 and 20X5.

- Preference shares in issue are convertible (at the option of the preference shareholders) into 50 000 ordinary shares on 31 December 20X7. If not converted, the preference shares will be redeemed on 31 December 20X7. Dividends of C1 000 are incurred annually on these preference shares (these have been correctly accounted for as finance charges). The preference shares were in existence throughout 20X4 and 20X5.

- There are no components of other comprehensive income.

- Normal tax is levied at 30%.

Required:

Disclose earnings per share in the financial statements of Dabchick Limited for the year ended 31 December 20X5.

Accounting policy notes are not required.

Question 8.16

The following relates to Late Night Limited for the year ended 31 December 20X5:

- Profit for the year C500 000 (20X4: C337 500). This profit includes a profit from discontinued operations (after tax) 52 500 (20X4: C0).

- On 1 January 20X4 there were 250 000 ordinary shares each with a par value of C5.00 in issue. On the 30 September 20X4 there was a rights issue on a basis of 1 ordinary share issued for every 5 already held at a price of C6.00. The market value of the ordinary shares immediately before the rights issue was C7.50 per share. On 31 May 20X5 there was an issue of 50 000 ordinary shares at market price (C5 per share).

- There are 25 000 options in existence, each of which allows the holder to acquire four shares at a strike price of C10.00 per share. The options have already vested but will only expire in many years to come. The average market price per ordinary share for 20X4 and 20X5 was C12.00. These options were in existence throughout 20X4 and 20X5.

- Preference shares in issue are convertible (at the option of the preference shareholders) into 50 000 ordinary shares on 31 December 20X7. If not converted, the preference shares will be redeemed on 31 December 20X7. Dividends of C1 000 are incurred annually on these preference shares (these have been correctly accounted for as finance charges). The preference shares were in existence throughout 20X4 and 20X5.

- There are no components of other comprehensive income.

- Normal tax is levied at 30%.

Required:

Disclose earnings per share in the financial statements of Late Night Limited for the year ended 31 December 20X5.

Accounting policy notes are not required.

Question 8.17

The following relates to Early Morning Limited for the year ended 31 December 20X5:

- Profit for the year C500 000 (20X4: C337 500). This profit includes a profit from a discontinued operation (after tax) of C52 500(20X4: C0).
- On 1 January 20X4 there were 250 000 ordinary shares each with a par value of C5.00 in issue. On the 30 September 20X4 there was a rights issue on a basis of 1 ordinary share issued for every 5 already held at a price of C6.00. The market value of the ordinary shares immediately before the rights issue was C7.50 per share. On 31 May 20X5 there was an issue of 50 000 ordinary shares at market price (C5 per share).
- There are 25 000 options in existence, each of which allows the holder to acquire four shares at a strike price of C10.00 per share. The options have already vested but will only expire in many years to come. The average market price per ordinary share for 20X4 and 20X5 was 12.00. These options were in existence throughout 20X4 and 20X5.
- Preference shares in issue are convertible (at the option of the preference shareholders) into 500 ordinary shares on 31 December 20X7. If not converted, the preference shares will be redeemed on 31 December 20X7. Dividends of C1 000 are incurred annually on these preference shares (these have been correctly accounted for as finance charges). The preference shares were in existence throughout 20X4 and 20X5.
- There are no components of other comprehensive income.
- Normal tax is levied at 30%.

Required:

Disclose earnings per share in the financial statements of Early Morning Limited for the year ended 31 December 20X5.

Accounting policy notes are not required.

Question 8.18

The following information is available for Klingbros Limited at 31 December 20X8.

	Note	20X8 C	20X7 C	20X6 C
Profit after tax		650 000	550 000	400 000
Issued ordinary shares of C1 each		?	?	683 750
10 000 C20 12% participating preference shares	1	200 000	200 000	200 000
75 000 C3 7% convertible preference shares	2	225 000	225 000	-
Options	6	N/A	N/A	N/A
40 000 C4 10% convertible debentures	7	16 000		

1. The participating preference shares are non-redeemable and non-cumulative, and participate to the extent of C1 for every C11 paid to ordinary shareholders.
2. The convertible preference shares (recognised as a liability) are cumulative and convertible at the option of the preference shareholder into ordinary shares at a rate of three ordinary shares for every four convertible preference shares on 31 December 20X8.

Finance costs deducted in arriving at profit after tax amount to C20 000. The preference dividend was declared in 20X8 together with the 20X7 preference dividend (recognised as finance costs on the preference share liability).

3. Options to acquire 67 500 ordinary shares in Klingbros Ltd after 1 January 20X9 at a strike price of C4 per share were issued on 1 January 20X8. The average market price of the shares during 20X8 was C9 per share.

4. Klingbros Limited purchased a majority holding in Happy Limited on 1 May 20X7. Part of the purchase price was settled by the issue of 165 000 ordinary shares of Klingbros Limited on that date. A further 25 000 shares are contingently issuable upon Happy Limited generating total profits of C50 million over five years. Happy Limited's profit for the year ended 31 December 20X8 was C30 million (20X7: C30 million).

5. 40 000 10% convertible debentures of C4 each were issued. These debentures are convertible on 28 February 20X9 at the option of the debenture holders into Klingbros Limited ordinary shares at a rate of two ordinary shares for every seven debentures. If not converted into ordinary shares they will be redeemed on 28February 20X9.

6. On 31 March 20X7, 50 000 ordinary shares were issued.

7. On 30 September 20X8, Klingbros Limited undertook a share buy-back of 200 000 ordinary shares at a premium of C4 per share.

Required:

Disclose earnings per share in the statement of comprehensive income of Klingbros Limited for the year ended 31 December 20X8 in accordance with International Financial Reporting Standards.

Question 8.19

Lambson, Golden and Myburg Limited is a listed KSE company.

Details for their current reporting period is as follows

- The correctly calculated profit after tax for the year ended 31 December 20X8 is C550 000 (20X7: C 400 000)

- At 31 December 20X7 the following were in issue:

  - 350 000 ordinary shares of C 3 par value each

  - 300 000 10% redeemable, cumulative preference shares of C3 each. The preference dividends for 20X8 have not yet been declared. The 20X7 preference dividends were declared on 30 November 20X7.

  - Options to acquire 40 000 ordinary shares in Lambson, Golden and Myburg limited after 30 November 20X9 at a strike price of C 6 per share. The average market price of the shares during 20X8 was C 10 per share

- The following transactions took place in 20X8:

  - 1 January 20X8 200 000 12% convertible debentures of C 2 each were issued. These debentures are convertible on 30 September 20X9 at the option of the debenture holders into Lambson, Golden and Myburg limited ordinary shares at a rate of one ordinary share for two debentures. If not converted into ordinary shares they will be redeemed on 30 September 20X9

  - On 31 March 20X8, there was a capitalisation issue of 2 ordinary shares for every 5 shares in issue. The capitalisation issue utilised current share premium as far as is possible so as to minimise the impact of this issue on retained earnings.

  - On 30 September 20X8 50 000 ordinary shares were issued at their market value on that date. Another such issue of 10 000 shares took place on 30 November 20X8 at their market value on that date.

  - On 20 October 20X8, 30 000 ordinary shares were offered to existing shareholders. The offer was fully subscribed for at C 7 per share on 31 October 20X8, when the market price was C 10 per share.

The following note is available:

5.Profit before tax	
Profit before tax is stated after taking the following into account	
Provision for environmental restoration	30 000
Plant - impairment	35 000
-depreciation	20 000

The corporate tax rate is 30%

Required:

Disclose the EPS in the statement of Comprehensive income and the notes to the financial statements of Lambson, Golden and Myburg limited for the year ending 31 December 20X8 in accordance with IFRS.

Part 2

Chapter 9
Statement of comprehensive income disclosure

Question	Key issues
9.1	Basic disclosure, including statement of comprehensive income, statement of changes in equity, notes, sale of non-depreciable asset above cost
9.2	Disclosure of accounting policies, revenue, operating expenses, income from subsidiaries, taxation
9.3	Deferred tax, disclosure of revenue, profit from operations and taxation
9.4	Error, change in estimate, EPS.
9.5	Error in prior and current year, revenue

Question 9.1

The financial director of St Kitts Limited is in the process of finalizing the financial statements for the year ended 28 February 20X7. The trial balance at that date is as follows:

ST KITTS LIMITED
TRIAL BALANCE AT 28 FEBRUARY 20X7

	Debit	Credit
Ordinary share capital		3 000 000
Share premium		1 500 000
Distributable reserves		1 424 200
Borrowings		2 000 000
Accounts payable		400 000
Accrued expenses		20 000
Property, plant and equipment	4 200 000	
Accounts receivable	1 100 000	
Accrued income	15 000	
Inventory	1 800 000	
Tax Refundable	200 000	
Cash at bank	2 059 200	
Revenue		12 000 000
Cost of sales	7 100 000	
Net operating expenses	3 480 000	
Interest on borrowings	240 000	
Share issue expenses	150 000	
	20 344 200	20 344 200

The following information is relevant:

- The authorised share capital comprises 10 000 000 ordinary shares of C0.50 each. During the year, 1 000 000 shares were issued at a price of C2.00. The issue of the shares has been correctly recorded in the accounting records. Share issue expenses of C150 000 were paid. The financial director wishes to account for these expenses with the minimum impact on distributable reserves.

- The borrowings relate to a loan taken out by St Kitts Limited on 1 July 20X4 for a three year period. The company does not have the right to defer settlement of the loan.

- The balance on the property, plant and equipment comprises property of C3 150 000 and plant and equipment of C1 050 000. Property is measured at valuation and plant and equipment is measured at cost. At year end, the directors engaged the services of an independent valuer who has valued the property at C3 950 000.

- During the year, an item of plant and equipment was sold for C330 000. This item of plant had cost C300 000 and to date of sale accumulated depreciation and tax allowances amounted to C120 000.

- The inventory has a net realisable value of C1 720 000 and the accounts receivable are expected to realise C980 000.

- Included in the operating expenses are depreciation of property, plant and equipment amounting to C210 000, salaries of C1 800 000, advertising of C35 000, repairs to equipment of C28 000 and auditors remuneration of C110 000.

- Dividends of C0.05 per share were declared on 25 March 20X7. The financial statements were authorised for issue on 30 March 20X7.

- The financial director wishes to present the face of the statement of comprehensive income and statement of financial position in accordance with the minimum requirements of IAS I.

  The current normal income tax rate is 29%.

Required:

a) Prepare the statement of comprehensive income of St Kitts Limited for the year ended 28 February 20X7, in accordance with International Financial Reporting Standards

b) Prepare the statement of changes in equity of St Kitts Limited for the year ended 28 February 20X7, in accordance with International Financial Reporting Standards

c) Prepare the current liabilities section of the statement of financial position of St Kitts Limited at 28 February 20X7, in accordance with International Financial Reporting Standards

d) Prepare the following notes to the financial statements in accordance with International Financial Reporting Standards

   - Statement of compliance and accounting policy for basis of preparation
   - Share capital, profit before tax, taxation expense and dividends

Ignore deferred tax

Question 9.2

The trial balance of World Limited at 30 June 20X2 is shown below. World Limited is an industrial company and a leader in researching environment friendly production methods.

WORLD LIMITED
TRIAL BALANCE AT 30 JUNE 20X2

		Debit	Credit
Sales			84 986 750
Dividend income	1		1 150 000
Interest income			430 000
Management fee income	1		900 000
Royalty income			175 000
Cost of sales		24 602 000	
Administrative and selling expenses	2	1 327 100	
Distribution expenses		185 400	
Audit fees	3	237 500	
Bad debts expense	4	1 180 000	
Depreciation expense		2 405 000	
Donations	5	75 000	
Impairment of inventory		1 307 500	
Maintenance of industrial plant	6	2 465 000	
Operating lease expenses		1 602 500	
Salaries expense		34 237 750	
Interest expense		367 500	
Ordinary dividend	7	2 750 000	
Current tax receivable	8	5 093 575	
Non-current assets		65 200 000	
Current assets		18 455 000	
Non-current liabilities			2 300 000
Current liabilities			7 500 000
Ordinary share capital			50 000 000
Retained earnings			14 049 075
		161 490 825	161 490 825

The following information is relevant:

1. The dividend income and management fee income is received from Summit Limited, a subsidiary of World Limited. *(Assume dividend income is exempt from tax)*

2. The administrative and selling expenses include an amount of C200 000 relating to insurance for the period from 1 October 20X1 to 30 September 20X2. The amount has been paid and is allowed as a deduction for tax purposes.

3. The audit fees comprise the following:

	C
Fee for audit	212 000
Tax consulting	12 500
Accommodation expenses	5 000
Travel expenses	8 000
	237 500

4. Included in the bad debts of C1 180 000 is an amount of C975 000 relating to a customer that went into liquidation in January 20X2. No further amounts are expected to be received. The amount is considered to be material.

5. The donations comprise amounts paid to the Green Planet Trust, a charitable organisation.

6. The maintenance of industrial plant of C2 465 000 includes an amount of C250 000 relating to installation costs of new plant purchased on 1 November 20X1. The invoice price of the plant (excluding the installation costs) and the related depreciation has been correctly recorded in the accounting records. World Limited accounts for depreciation at 15% per annum on the straight line method.

   The tax authority has granted a total tax allowance on the industrial plant of C3 382 000 for the year ended 30 June 20X2.

7. The ordinary dividend was declared on 28 June 20X2.

8. The balance on the Current Tax Payable/ Receivable account of C5 093 575 represents provisional tax payments for the year ended 30 June 20X2. No entry has been made in respect of an over-provision of tax of C450 000 for the year ended 30 June 20X1.

   The company tax rate is 30%.

Required:

Prepare the statement of comprehensive income and accompanying notes of World Limited for the year ended 30 June 20X2 in accordance with the requirements of International Financial Reporting Standards.

Include accounting policies for the basis of preparation and revenue recognition.

Comparatives are not required.

The deferred tax note is not required.

Earnings per share is not required.

Question 9.3

The following is an extract from the trial balance of Electoral Limited at 31 March 20X4:

ELECTORAL LIMITED
EXTRACT FROM TRIAL BALANCE AT 31 MARCH 20X4

	Debit	Credit
Gross profit		2 000 000
Other income		1 860 000
Distribution expenses	1 200 000	
Administration expenses	1 000 000	
Other operating expenses	2 807 000	
Interest expense	250 000	
Royalties received in advance - 1 April 20X3		30 000
Rates and taxes paid in advance - 1 April 20X3	25 000	
Underprovision of tax in prior years	5 000	
Deferred taxation - 1 April 20X3		350 000
Manufacturing plant	2 000 000	
Motor vehicles	1 000 000	
Computer equipment	500 000	
Furniture and fittings	500 000	

Additional information:

- Revenue comprises:

	C
Sales of ballot papers to the government	7 500 000
Services rendered with respect to election day	5 000 000

- Other income comprises the following items:

		C
Rent received from investment property		1 500 000
Royalties received	(According to the royalty agreement, royalties of C10 000 are due every month)	100 000
Interest received on debentures	(Electoral Limited holds 1000 C100 12% debentures, which were purchased in 20X0)	10 000
Interest received from money market investment		140 000
Profit on sale of manufacturing plant		110 000
		1 860 000

- Dividends received:
  - Electoral Limited has a 5% share in United Freedom Limited, a company listed on the stock exchange. United Freedom Limited paid an interim dividend of C100 000 to shareholders in September 20X3, and declared a final dividend of C200 000 on 20 March 20X4, to shareholders registered on 31 March 20X4.
  - Electoral Limited received a dividend of C20 000 from their investment in an unlisted company, Democracy for All (Pvt) Ltd.
  - Dividend income is exempt from tax

- The following items of expenditure are *included* in the distribution, administration and other operating expenses:

		C
Audit fees		
- Fee for audit		250 000
- Expenses		12 000
- Fees paid for tax consulting services		10 000
Depreciation charge for the year		900 000
Operating lease payments		600 000
Rates and taxes paid	(Includes an amount of C40 000 relating to April and May 20X4)	145 000
Salaries		1 000 000

Wages		800 000
Traffic fines		10 000
Legal fees	(C5 000 is not tax deductible	75 000
Donations	(C20 000 is not tax deductible)	50 000

- Property, plant and equipment:
  - An item of manufacturing plant was sold during the year at a selling price of C360 000. The plant had cost C300 000 on purchase. At the date of sale the carrying amount of the plant was C250 000 and the tax base was C200 000.
  - Wear and tear allowances of C1 165 000 in total were allowed by the tax authorities for the year. The tax base for the various items of non-current assets at 31 March 20X4 were as follows:

	C
Manufacturing plant	1 050 000
Motor vehicles	1 200 000
Computer equipment	300 000
Furniture and fittings	230 000

- An interim dividend of C115 000 was paid in October 20X3. A final dividend of C130 000 was declared on 5 April 20X4, payable to shareholders registered on 14 April 20X4.
- The normal tax rate for the year ending March 20X3 was 35% and decreased to 30% for the year ended March 20X4.

Required:

a) Prepare a deferred taxation computation worksheet showing the carrying amount, tax base and temporary difference applicable to each relevant statement of financial position item, indicating the nature of the temporary difference (taxable or deductible) as well as the total movement in deferred taxation for the period.

b) Prepare the statement of comprehensive income of Electoral Limited for the year ended 31 March 20X4, in accordance with International Financial Reporting Standards.

c) Prepare the notes to revenue, profit before tax and taxation for the year ended 31 March 20X4, in accordance with International Financial Reporting Standards.

Accounting policies are not required.

Comparatives are not required

Question 9.4

Mango Limited, a listed company in the travel goods industry, was incorporated during 20X1 with an issued share capital of:

- 150 000 12% cumulative, non-redeemable preference shares
- 200 000 10% non-cumulative, non-redeemable preference shares
- 400 000 ordinary shares of C1 each issued at a premium of 0.50 cents

Since incorporation the only changes to the capital structure of Mango Ltd were a fresh issue of 100 000 ordinary shares at a premium of C1 on 1 July 20X4 and a capitalisation issue of 1 share for every 5 held on 1 April 20X5. It is company policy to utilise the share premium account to the maximum extent possible.

The following are the draft statement of comprehensive income and draft statement of changes in equity of Mango Limited for the year ended 31 December 20X5:

MANGO LIMITED
DRAFT STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X5

	20X5	20X4
	C	C
Revenue	7 200 000	5 400 000
Cost of sales	(3 600 000)	(2 160 000)
Gross profit	3 600 000	3 240 000
Other income	550 000	300 000
Other expenses	(880 000)	(760 000)
Profit before tax	3 270 000	2 780 000
Income tax expense	(960 550)	(808 950)
Profit for the period	2 309 450	1 971 050
Other comprehensive income	-	-
Total comprehensive income	2 309 450	1 971 050

MANGO LIMITED
EXTRACT FROM DRAFT STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X5

	Retained earnings	
	20X5	20X4
	C	C
Balance at 31/12/X4	2 550 132	579 082
Total comprehensive income	2 309 450	1 971 050
Dividends paid	156 000	-
Ordinary dividends	100 000	-
12% Preference dividends	36 000	-
10% Preference dividends	20 000	-
Balance at 31/12/X5	5 015 582	2 550 132

The following information is relevant

- Shortly before the end of December 20X5, the company auditors discovered that the sales manager, Mr Leo, had recorded several fictitious credit sales invoices amounting to C 150 000 during the 20X3 financial year and C 500 000 during the 20X4 financial year. Mr Leo's motive in doing this was to obtain additional sales commission, earned at 5% of the total annual sales generated by him. The commission was paid to Mr Leo at the end of 20X3 and 20X4 respectively. The company will proceed to recover the commission from the sales manager. The above is considered to be material and no entries have been processed to correct the fraud.

- On 1 April 20X2, Mango Ltd bought the rights to manufacture a range of light weight, indestructible umbrellas at a cost of C750 000. The cost was correctly recognised as an intangible asset and is being amortised over its expected useful life of 15 years to a nil residual value using the straight –line method.

  During December 20X5 it was determined, however, that the expected useful life of the purchased right was only 10 years. The company has decided to use the reallocation method to adjust for a change in an accounting estimate.

  The financial manager had calculated the annual amortisation charge (as per the draft statement of comprehensive income) using an estimated useful life of 15 years.

- The profit before tax in 20X4 includes a loss on disposal of land of C85 000 and the 20X5 profit for the period includes an amount of C40 000 relating to the impairment of an item of equipment to its recoverable amount.

- The tax authorities grant the following applicable wear and tear allowances and deductions and will re-open the tax assessments for the prior years:

  - intangible assets: 10% per annum straight line (not apportioned for time)
  - commission paid is fully deductible

- The normal company tax rate is 29%

***Required*:**

a) Prepare the journal entries to account for the error and the change in estimate in the accounting records of Mango Ltd for the year ended 31 December 20X5.

b) Prepare the statement of comprehensive income and statement of changes in equity of Mango Ltd for the year ended 31 December 20X5 in accordance with International Financial Reporting Standards.

c) Prepare notes to EPS in terms of IAS 33 *Earnings per share*

Comparatives are required only for (b) and (c).

The statement of financial position and related notes as well as accounting policies are not required

Question 9.5

Chartwell Limited discovered two problems during their financial year ended 31 December 20X6:

- a glitch in their computerized accounting programme that arose during 20X6; and

- the use of an incorrect discount rate when measuring revenue from an instalment sale.

The computer glitch:

- The computer glitch resulted in 10% of all income from services rendered during 20X6 being allocated to the 'income from sale of widgets' account.

- This error was compounded by the fact that royalties are payable by Chartwell Limited based on 2% of total annual sale of widgets, as reflected on the trial balance.
- The royalty expense is deductible for tax purposes on the accrual basis (i.e. in the year in which they are incurred).

The incorrect discount rate:

- The incorrect discount rate involved an instalment sale transaction that was measured using a discount rate of 17% instead of 7%.

- The instalment sale agreement requires three arrear annual instalments of C300 000 each to be paid to Chartwell Limited on 30 June of each year. This agreement was signed on 1 July 20X4, on which date all the criteria for recognition as a sale were met.

- The income from this sale, using the 17% discount rate, was therefore measured at C662 876. Had the 7% discount rate been used instead, the sale would have been measured at C787 295.

- The tax authorities tax the income from this sale on the accrual basis (i.e. in the year in which the income is earned).

The following is the trial balance of Chartwell Limited for the year ended 31 December 20X6, before making any adjustments that may be necessary as a result of the two errors identified above:

CHARTWELL LIMITED
TRIAL BALANCE AT 31 DECEMBER 20X6

	Debit	Credit
Income from instalment sales		980 000
Income from sale of widgets		200 000
Income from services rendered		900 000
Dividend income		400 000
Interest income		260 000
Cost of sales and services	1 500 000	
Interest expense	30 000	
Operational expenses (20% administration; 30% distribution; 50% other)	200 000	
Royalty expense (to be classified as 'other expense')	4 000	
Tax expense	285 000	
Share capital		200 000
Share premium		78 000
Retained earnings: 1 January 20X6		331 800
Dividends declared: 30 June 20X6	50 000	
Property, plant and equipment	864 800	
Current tax payable		30 000
Deferred tax		15 000
Creditors		182 000
Debtors	528 000	
Royalty payable		5 000
Bank	120 000	
	3 581 800	3 581 800

The following is extract of the statement of financial position of Chartwell Limited as at 31 December.

CHARTWELL LIMITED
EXTRACT OF THE STATEMENT OF FINANCIAL POSITION
FOR THE YEARS ENDED 31 DECEMBER 20X5 AND 20X4

	20X5	20X4
Debtors	3 200 000	2 400 000
Retained income	331 800	11 800
Deferred tax liability	320 000	300 000
Current tax payable	52 000	40 000

Additional information:

- The financial year end is 31 December.
- Normal tax is levied on taxable profits at 30%.
- The tax authority will not re-open the tax assessments for 20X5 and/ or any prior years. Any adjustments necessary will therefore have to be included in the 20X6 tax returns.
- The entity's accounting system is unable to re-open the trial balances before 20X5 with the result that all adjusting or correcting journal entries must be processed in the relevant years of 20X5 and/ or 20X6.
- The profit recognized in 20X5 was C320 000.
- There were no dividends declared in 20X5.
- There was no movement in share capital and no transfers to or from the retained earnings during either 20X5 or 20X6.
- All items are considered material.

Required:

a) Process all *correcting* journal entries related to the computer glitch that would be required in order to finalise the financial statements for the year ended 31 December 20X6.

b) Produce the effective interest rate table necessary to measure revenue from the sale transaction using the previously used 17% discount rate.

c) Produce the effective interest rate table necessary to measure revenue from the sale transaction using the correct 7% discount rate.

d) Process all *correcting* journal entries related to the use of the incorrect discount rate that would be required in order to finalise the financial statements for the year ended 31 December 20X6.

e) Disclose the correction of error note and revenue note to be included in the notes to the financial statements for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

f) Prepare the statement of comprehensive income for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

g) Prepare the statement of changes in equity for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

h) Prepare the statement of financial position as at 31 December 20X6 in accordance with International Financial Reporting Standards.

Part 3

Chapter 10
Property, plant and equipment and impairment of assets

Question	Key issues
Section A	**Recognition, measurement at recognition, measurement after recognition (depreciation), derecognition and disclosure**
10.1	Basic disclosure, accounting policies and notes
10.2	Basic disclosure, notes including capital commitments
10.3	Elements of cost, subsequent costs, components, depreciation period: journals
10.4	Recognition of separate components, decision to expense or capitalise, depreciation of separate components: journals and disclosure
10.5	Recognition of separate components, decision to expense or capitalise, depreciation of separate components, change in estimate and journals
10.6	Recognition of separate components, inspection costs: journals
10.7	Self-constructed asset, construction costs, depreciation: journals and disclosure
10.8	Internal manufacture of an asset, exchange of asset, repair of asset: discussion
10.9	Understanding: residual value, recognition principle, depreciation period, depreciation, inspection costs
Section B	**Measurement after recognition (cost model and revaluation model), impairments and disclosure**
10.10	Impairment test, recoverable amount, residual amount and net realisable value
10.11	Initial measurement, objective of and test for impairment, re-assessment of recoverable amount, disclosure, using cost model
10.12	Initial measurement, test for impairment, journal entries, using cost model
10.13	Journals and disclosure Part A: Cost model: impairment followed by impairment reversal Part B: Revaluation model: impairment followed by revaluation increase Part C: Revaluation model: revaluation decrease followed by revaluation increase
10.14	Cost and revaluation models compared: - journal entries with and without tax effects
10.15	Revaluation model: journals without tax: Revaluation increase, followed by a revaluation decrease then a revaluation increase
10.16	Revaluation model, revaluation increase followed by revaluation decrease below historic carrying amount Part A: Journals and disclosure (ignoring tax consequences) Part B: Journals and disclosure (with tax consequences)

10.17	Revaluation model, revaluation increase, followed by a revaluation decrease above historic carrying amount Part A: Journals and disclosure (ignoring tax consequences) Part B: Journals and disclosure (with tax consequences)
10.18	Revaluation model, revaluation increase followed by revaluation decrease below historic carrying amount with disclosure in the financial statements
10.19	Revaluation model, revaluation increase followed by a revaluation decrease above historic carrying amount, apportionment of depreciation and tax allowances, journals and disclosure
10.20	Cost model: impairments and reversals of impairments, journal entries and disclosure
10.21	Cost model, impairments and reversals: Part A: Ignoring tax consequences, journals and disclosure Part B: With tax consequences, journals and disclosure
10.22	Revaluation model, (revaluation increase / decrease): journals and disclosure
10.23	Gross replacement method vs. net replacement method
10.24	Revaluation model disclosure
10.25	Initial costs

Question 10.1

The following is an extract from the trial balance of Kershaw Limited for the year ended 30 June 20X4:

KERSHAW LIMITED
EXTRACT FROM TRIAL BALANCE AT 30 JUNE 20X4

	Debit	Credit
Land acquired 1/1/20X2, at cost	80 000	
Office buildings erected 30/6/20X4, at cost	50 000	
Fixtures and fittings, at cost	60 000	
Accumulated depreciation of fixtures and fittings at 1/7/20X3		10 000

Depreciation is calculated at 10% per annum reducing balance on fixtures and fittings. No depreciation is calculated on land. Buildings are depreciated at 2% per annum on the straight line basis.

All residual values are assessed to be zero and this has remained unchanged since acquisition.

***Required*:**

Prepare the property, plant and equipment note to the financial statements for the year ended 30 June 20X4.

Accounting policies are required.

Comparatives are not required.

Question 10.2

Treasure Limited purchased land for C 120 000 during the current year. The following transactions have taken place regarding the construction of a building on the land:

- A contract for the clearing of land amounting to C 20 000 was concluded. A progress report at 31 March 20X3 was received showing that one quarter of the land had been cleared, but no payments have yet been made. The clearing was preparatory to the construction of the building.

- An architect has been consulted in relation to plans for the new building. He will commence work in April 20X3 at an agreed fee of C 10 000.

- The directors have authorised the signing of a contract with AB Builders Limited to the value of C 120 000 for the construction of the building. Construction has not yet commenced.

- The directors have also approved the issue of 100 000 C 1.15% redeemable, unsecured debentures at 4% discount in order to finance the above expenditure. These debentures were issued on 31 March 20X3 and will be redeemed at par on 1 April 20X8. The balance of the funds required to pay for the building will be derived from cash generated by operations.

Required:

Show how the above would appear in the financial statements and notes of Treasure Limited for the year ended 31 March 20X3 in terms of International Financial Reporting Standards.

Accounting policy notes are not required.

Question 10.3

Olympic Limited is a diversified industrial company with many different areas of operation. The following information relates to the company's property, plant and equipment. The company has a 30th September year end.

- All the plant was purchased and brought into use on 1 October 20X1 at a cost of C 800 000. The cost of testing the plant amounted to C 45 000 and samples manufactured while in the testing phase were sold for C 5 000. The useful life of the plant is estimated at five years and the residual value is estimated at C 40 000. At 30 September 20X4, similar items of plant of five years age are currently realising C 70 000. The production director, however, expects the entity to obtain C 100 000 on disposal. The entity applies the re-allocation method.

- The motor vehicle consists of a delivery van purchased on 1 October 20X3 at a cost of C 270 000. The useful life is estimated at four years and the residual value is estimated at C0. At 30 May 20X4, the tyres of the delivery van are replaced with tyres of a better quality. The new tyres cost C 24 000 and have an estimated useful life of two years. It is estimated that the original tyres cost C 12 000. Costs of servicing the delivery van during the year amounted to C 12 500.

- A helicopter was purchased on 1 October 20X0 at a cost of C 1 500 000. The following components were identified:

	Cost	Residual value	Useful life
	C	C	Years
Airframe	800 000	0	10
Interior	100 000	0	10
Engines & rotar blades	400 000	30 000	5
Inspection	200 000	0	3

In order to maintain the operating license for the helicopter, inspections are required to be performed every three years on the anniversary of the purchase date. The cost of the inspection at 1 October 20X3 amounted to C 240,000.

- A photocopy machine was purchased for the office at a total cost of C 280 000 and delivered to the premises of Olympic Limited on 15 January 20X4. The machine needed to be installed by a technician and this was completed by 31 January 20X4. The machine was available for use on this date. However, management decided not to use the machine until 1 March 20X4 as an existing photocopy machine was on lease until that date. Use of the machine began on 1 March as planned and the machine was used continuously throughout the financial year except for the month of August 20X4 when a new high tech machine was given to Olympic Limited on a trial basis. The useful life of the machine is estimated at 3 years and the residual value is estimated at C 40 000.

- The normal tax rate has remained at 30% throughout the periods under review.

***Required*:**

Prepare all the journal entries relating to the property, plant and equipment of Olympic Limited for the year ended 30 September 20X4.

Question 10.4

Ancient Waters Limited is a company involved in bottling spring water. The company purchased a bottling plant on 2 January 20X2. The plant is made up of three significant components, the cost of which is as follows:

Description of component:	Cost price C	Residual value C	Expected useful life
Engine	1 500 000	500 000	5 years
Conveyor belt and fittings	2 000 000	0	8 years
Outer structure	800 000	50 000	3 years

Other costs incurred in relation to the bottling plant are as follows:

Description of cost:	C	Transaction date
Delivery and installation	750 000	5 January 20X2
Staff training	60 000	16 January 20X2
Testing to ensure plant fully operational before start of production	33 000	19 January 20X2
Launch party	210 000	21 January 20X2
Initial operating loss	45 000	March 20X2

Other information:

- The plant was available for use in production on 1 February 20X2, although production only began on 1 March 20X2.
- The plant was temporarily idle during December 20X2 when the factory closed down for its annual holiday period.
- The company uses the straight-line method when depreciating its bottling plant (not apportioned for part of a month).
- All 'other costs' are considered to be incurred evenly between the three significant components of the bottling plant (i.e. where appropriate, a third of the cost is allocated to each component).
- The only other asset owned by Ancient Waters Ltd is land which was purchased on 5 December 20X0 for C 4,000,000. The land is not depreciated.

Required:

a) Show all related journal entries relating to the bottling plant for the year ended 31 December 20X2 and 20X3. Round to the nearest C1.

b) Disclose the 'property, plant and equipment' note in the financial statements of Ancient Waters Limited for the year ended 31 December 20X3.

Ignore the effects of taxation.

Question 10.5

Unwind Ltd operates in the building industry. It is a vendor for VAT purposes. The following schedule of property, plant and equipment was relevant as at 31 December 20X3, the end of the ***previous*** financial year:

	Date of purchase	Cost C	Residual Value C	Useful life
Equipment	1 January 20X1	180,000	0	9 years
Light aircraft	1 January 20X1	380,000	80,000	
- bodywork and interior		80,000	0	8 years
- engines and propellers		200,000	80,000	15 000 miles
- inspection		100,000	0	4 years
Vehicle	1 January 20X3	100,000	10,000	4 years

Subsequent information relating to the property, plant and equipment follows:

Equipment

- A fire in the warehouse in late December 20X3 damaged the equipment. The recoverable amount of the equipment was estimated at 31 December 20X3 to be C 105,000.
- The equipment was partially repaired on 5 January 20X4 at a cash cost of C 30,000. This was paid for on the day of repair and no VAT was charged.
- The recoverable amount of the equipment was estimated to be C 114,000 immediately after the repair.

Light aircraft

- The aircraft requires a major inspection every 4 years.
- It was inspected on 27 December 20X4 at a cost of C 171,000 (including VAT). This was paid for on the date of inspection.
- It has been estimated that the next major inspection will cost C 205,200 (including VAT).
- The aircraft flew 3,000 miles in 20X4.

Vehicle

- It is expected that this vehicle will sell for C 25,000 (excluding VAT) at the end of its useful life in two year's time. Similar assets that are four years old have realised C 17,500 on sale.
- The company uses the re-allocation method to account for changes in accounting estimates.

Computer

- A new computer was purchased and paid for on 24 December 20X3 (cost: C 57,000, including 14% VAT) but delivered on 15 March 20X4.
- The software necessary to run the computer was installed on 1 April 20X4, before which the computer was not able to be used.

- The computer was brought into use a month later on 1 May 20X4 and was used continuously except for the month of August 20X4, during which time technical problems were experienced, requiring the software to be reinstalled. The reinstallation could only be done by the same technician who performed the original installation. The computer was not impaired in any way. The technician carried out the reinstallation on 1 September 20X4 at no cost to Unwind Ltd.
- The residual value is nil and the useful life is 5 years.

Required:

Prepare all journal entries relating to the property, plant and equipment of Unwind Ltd for the year ended 31 December 20X4. Set your answer out as follows:

a) Journal entries relating to the equipment

b) Journal entries relating to the aircraft

c) Journal entries relating to the vehicles

d) Journal entries relating to the computer

Question 10.6

Dolphin Limited owns only two items of property, plant and equipment:

- a medical waste disposal plant (carrying amount at 31 December 20X3: C 5,600,000); and
- a ship that was purchased on 2 January 20X4 (purchase price: C 20,000,000).

There were no sales and no other purchases of property, plant and equipment during 20X4.

The purchase price paid for the **ship** has been analysed as follows into the estimated cost per significant component:

Description of component	Cost	Comments
	C	
Hull	10 000 000	Estimated useful life of 8 years with a residual value of C 2 000 000
Engine room	9 000 000	Estimated useful life of 1 000 000 nautical miles with a nil residual value
Major inspection (which had been performed on 5 January 20X2)	1 000 000	Major inspections are a pre-requisite to the continued use of the ship. The next major inspection was due and performed on 30 June 20X4 at a cost of C 6 000 000 – paid in cash. The following major inspection is due on 31 December 20X6 at an expected cost of C 7 500 000.
Total price paid (2/Jan/20X4)	20 000 000	

- Depreciation on the **medical waste disposal plant** was C 2,800,000 in 20X4 (being the total depreciation on all of its components). Depreciation is provided on the medical waste disposal plant using the straight-line method.
- Depreciation on the **ship** is to be provided on the sum of the units method where possible. Where this method is inappropriate, the straight-line method is to be used instead. The ship travelled 100,000 nautical miles during 20X4.

Required:

Journalise the movement in the carrying amount of property, plant and equipment for the year ended 31 December 20X4.

Ignore tax effects.

Question 10.7

Roads International Limited constructed its own specially designed 'tarring vehicle'. Details of related costs incurred are as follows:

Description of cost:	C	Transaction date
Cost of raw materials purchased	500 000	1 February 20X2
Cost of raw materials used in construction of tarring vehicle during June 20X2	100 000	
Tests to ensure vehicle safe before brought into use	20 000	30 September 20X2
Depreciation on machinery to 31 December 20X2	200 000	
Factory labour costs to 31 December 20X2	300 000	

Additional information:

- The company-owned machinery was used for a quarter of the year in the construction of the tarring vehicle.
- 80% of the total labour costs for the year were incurred on building roads and 20% thereof were incurred in construction of the tarring vehicle. Of the total labour cost incurred on the construction of the tarring vehicle, an estimated 5% was as a direct result of a country-wide labour union strike during which labourers were paid but yet did not turn up for work.
- The vehicle was first brought into use on a contract that started on 1 November 20X2, although it was available for use from 1 October 20X2.
- The company uses the straight-line method to depreciate its vehicles. This vehicle is expected to be sold for C 50 000 at the end of its expected useful life of 5 years. A similar vehicle realised C 7 000 when sold at the end of 20X2.

Required:

a) Journalise all related transactions for the year ended 31 December 20X2.

b) Disclose the vehicle in the 'property, plant and equipment' note and the separately disclosable item: 'depreciation' in the notes to the financial statements of Roads International Ltd for the year ended 31 December 20X2.

Comparatives are not required.

Ignore the effects of taxation.

Question 10.8

You are the auditor of a large manufacturing company called Yoyo Limited, which has a December year-end. With the implementation of International Financial Reporting Standards, the accountant of Yoyo Ltd feels that he has lost touch with the basic principles governing the accounting treatment of certain elements. He has approached you regarding three issues that need clarification before the current financial statements for the year ended 31 December 20X0 may be finalised.

Issue a) Internal manufacture of machine B

Included in non-current assets in Yoyo Limited's statement of financial position at 31st December 20X0 is 'Machine B' at a carrying amount of C 400 000. Machine B was manufactured by Yoyo Limited during April 20X0. The machine was completed and available for use on 1 May 20X0 and was brought into commercial production on 31 May 20X0. Included in the cost of C 400 000 were the following amounts:

- Raw materials of C 150 000 (including C 20,000 materials that were destroyed when a strike by the workers ended in a warehouse being set alight).
- Depreciation of other machinery used in the manufacture of Machine B: C 80 000.
- Labour costs of C 100 000.
- Administration overheads of C 70 000

Issue b) Acquisition of a crane

Yoyo Limited owns only one crane, which is included in property, plant and equipment at C 500 000 at 31st December 20X0. This crane was acquired at 31 December 20X0 by exchanging the previously owned crane (with a carrying amount of C 500 000) stationed at the Durban harbour mouth for the newly acquired crane situated at the Richard's Bay harbour mouth. The accountant is aware that the fair value of the newly acquired crane is actually C 400 000 but believes that no adjustment is required since this is considered to be an 'exchange of similar assets'. He added that although it would appear that the company made a loss in the exchange of the two cranes, this is offset by the savings in not having to physically move the Durban crane to the Richard's Bay harbour where the crane would need to be stationed from now on. Relocation costs were expected to be approximately C 100 000.

Issue c) Repainting of administration building

The administration building was repainted during the current year ended 31st December 20X0 at a cost of C 300 000. The cost of painting was capitalised to the building on the grounds that the cost of painting was 'unavoidable' since the directors believed that the building was 'looking shabby' and that this was 'detrimentally affecting business'.

Required:

Critically analyse each of the above issues, explaining whether the treatment is correct or incorrect and justifying your advice with references to International Financial Reporting Standards.

Your answer must be broken down into three separate discussions under the headings given.

Question 10.9

The managing director and financial director are reviewing schedules supporting the draft financial statements of Collingwood Limited for the year ended 30 June 20X6.

a) MD: "I see that the production engineers estimate that we will be able to sell Plant A for an amount of C 100 000 at the end of its useful life in two years time. Why have you used a residual value of C 70 000 in the calculation of depreciation?"

FD: "Plant A has an estimated useful life of five years and we have used the item for three years. We recently sold a similar item, Plant B, which we had used for five years, for an amount of C 70 000".

MD "That is irrelevant – our production engineers, who know best, estimate that we will receive C 100 000 at the end of its useful life"

b) MD: "We replaced the existing ventilation system in the factory with a new system at a cost of C 240 000 – why has the cost been included as an asset on the statement of financial position and not expensed in the statement of comprehensive income?'

FD: "It meets the requirements of Para 7 of IAS 16"
MD: "Huh? . . . We have not enhanced the system; all we have done is to maintain the existing level of ventilation in the factory"

c) MD: "Do you recall that new computerized component which we purchased at the beginning of our financial year? We only started using it on 1 September 20X5 but I see that depreciation has been taken into account from 1 August 20X5.

FD: "It was available for use from 1 August"

MD: "Yes, but we only activated it on 1 September. It was not used during August. How can you allocate depreciation on an item that has yet to be used?"

d) MD: "The independent valuer that we hired placed a fair value on our property of C 8,000,000 at the end of the year. The statement of financial position at the end of last year showed the property at a cost of C 5 000 000 with accumulated depreciation of C 2 000 000."

FD: "And so?"

MD: Well, you have depreciated the property by C 50 000 during the current year. How can you do this when the value has increased?"

e) MD: "I am very pleased with the new corporate jet that we purchased. I just don't understand your schedule that shows an inspection cost of C 750 000 as part of the asset cost. All I remember seeing is an invoice for the total purchase cost of C 3 500 000 and the aircraft is only due for its next inspection in three years time"

FD: "C 750 000 is the current market price of an inspection for a three year old aircraft"

MD: "What? . . . We bought an aircraft for C 3 500 000 and that is that."

Required:

Identify the issue in each of the dialogues and explain, with reference to IAS 16, the correct accounting treatment in each case.

Question 10.10

You are the auditor of a large bathroom supplies company called The Running Tap Ltd, which has a December year-end. With the extensive changes to IFRS, the accountant of The Running Tap Ltd feels out of touch with the basic principles to use when accounting for assets. He has approached you regarding two issues that need clarification before the current financial statements for the year ended 31 December 20X0 may be finalised.

Issue A: Impairment tests

All of the non-current assets were revalued during the current year. For this reason no impairment tests were performed on any assets during the year.

Required:

a) Discuss whether you agree or disagree with the decision not to perform impairment tests.

b) Although the accountant does not believe that he has to perform any impairment testing, he has requested that you explain what this would involve if it was necessary for him to perform an impairment test.

Issue B: Recoverable amount, Residual amount and Net realisable value

The accountant has asked you to clarify the meaning and use of these three terms.

Required:

Explain the meaning and use of these three terms. Your answer should include an explanation of how each of these three amounts is used, and how these three amounts would be calculated.

Question 10.11

Wien Limited manufactures coffee machines for the domestic and industrial markets. On 2 January 20X3, Wien Limited purchased new equipment to computerise the molding of the range of coffee machines that it produces. The equipment was available for use on 2 January 20X3 but was brought into use on 2 February 20X3.

The invoice received from the supplier reflected the following:

	C
List price of model 123	520,000
VAT at 14%	72,800
	592,800

Wien Limited is a registered vendor for VAT purposes.

In addition, Wien Limited paid C 18 000 delivery costs to a road haulage contractor and C 12 000 to a professional engineer for advice on installation. While the equipment was being

assembled, one of Wien Limited's employees damaged the equipment costing the company an additional C 2 000 for repairs. The repair did not constitute a replacement or renewal of a major component.

The accounting policy of Wien Limited in relation to machinery is to provide for depreciation at 10% per annum on the straight line method. The residual value at the date of acquisition was estimated to be C 50 000. The tax authorities agreed to the same rate for tax purposes.

While preparing the financial statements for the year ended 31 December 20X7, management were of the opinion that the machine might be impaired. There is an active market for this type of equipment and at 31 December 20X7 it could have been disposed of to a knowledgeable, willing buyer for C 270 000. The costs of dismantling and removing the machine were estimated at C 15 000. The present value of the expected return from the use of the machine over the remainder of its useful life amounted to C 249 000 and the present value of the estimated residual value amounted to C 31 000.

At 31 December 20X9, there is evidence from internal reporting that the economic performance of the asset has been better than expected and the recoverable amount is re-estimated. The fair value less costs to sell is estimated to be C 170 000 and the value in use is estimated to be C 198 000. The company uses the cost model to measure its property, plant and equipment.

Required:

a) State the amount to be recorded as the initial cost of the equipment in the accounting records of Wien Limited. Give reasons for your answer.

b) Briefly discuss the objective of the test for impairment and elaborate on the calculation required to identify whether an asset is impaired.

c) Calculate, using the criteria in IAS 36 'Impairment of Assets', whether the equipment is impaired at 31 December 20X7.

d) Provide an extract from the notes to the financial statements of Wien Limited at 31 December 20X7 showing all the disclosure relating to the equipment. .

e) Calculate the effect of the re-assessment of the recoverable amount of the equipment at 31 December 20X9 and describe the impact of the reassessment on the financial statements and notes thereto.

Ignore deferred tax

Question 10.12

Lesutu Fisheries is a company fishing the Katse Dam and selling the fish to the public via a retail outlet in a nearby village. Lesutu Fisheries has two small fishing boats that were purchased for a total amount of C 30 000 (C 15 000 per boat) on 1 January 20X0. The cost of transporting the boats to the dam was C 7 ,000 (in total), and the cost of varnishing the boats with marine varnish (to protect against rotting in the water) was C 13 000 (in total). In order to improve the company image, the board of directors decided to paint the boats in its company colours of yellow and blue. This was done immediately after applying the protective varnish at a total cost of C 10 000.

The company uses the cost model to measure its assets. The boats are depreciated over their estimated economic useful life of 3 years on the straight-line basis. The current selling price

of similar boats in the same condition expected of the boats after 3 years is C 5 000 (C 2 500 per boat), before taking into account the estimated cost of delivery of the boats to the purchaser of C 3 000 (C 1 500 per boat).

At 30 June 20X0, the financial year-end of Lesutu Fisheries, the boats collided with each other in the dam. The market value per boat dropped to C 7 000 as a result, before taking into account expected selling costs of C 4 000 per boat. The accountant is reluctant to make any adjustments since the most recent management approved budgets reflects a relatively unchanged profit forecast from the use of the two damaged boats - a net present value of C 30 000 from the use of the two damaged boats (C 15 000 per boat) and an estimated net present value of the net proceeds from the sale of the two damaged boats at the end of their useful life of C 2 000 (C 1 000 per boat).

Lesutu Fisheries received an insurance payout on 3 July 20X0 of C 25 000 (C 12 500 per boat). The two damaged boats were traded in for two new boats valued at C 33 000 (C 16 500 per boat) on 4 July 20X0. The trade-in value received for the two damaged boats was C 9 000 (C 4 500 per boat) and the balance owing was paid by cheque. The two new boats are to be depreciated at 20% per annum on the straight line method to a zero residual value.

Required:

a) Calculate the total amount at which the original boats should initially be measured.

b) Calculate the recoverable amount and the impairment loss, if applicable, at 30 June 20X0.

c) Journalise all transactions affecting the fleet of boats up to the year ended 30 June 20X1.

Ignore deferred tax and VAT.

Question 10.13

Part A
Wanderers Limited is a small listed company producing components for satellites that monitor pollution levels across the globe. Its financial year end is 30 June.

The accounting policy of Wanderers Limited relating to equipment reads as follows:

> *'Equipment is carried at cost less accumulated depreciation and accumulated impairment losses. Depreciation is provided at 20% per annum on the straight line basis.'*

The company purchased an item of specialised equipment at a cost of C 800 000 on 1 July 20X0. Details regarding this equipment follow:

- At 30 June 20X1, significant developments in technology by competitors led management to assess the recoverable amount of the equipment. The fair value less costs to sell was estimated at C 440 000 and the value in use was determined to be C 380 000.

- Towards the end of the 20X3 financial year, it became apparent that the competitors' new technology developed in 20X1 was not commercially viable. The recoverable amount was assessed again and based on market prices, management estimated the fair value less costs to sell to be C 500 000 and the value in use to be C 400 000.

- The estimated useful life has remained unchanged throughout. The residual value is estimated to be nil (unchanged).

Profit before tax for the year ended 30 June 20X3 *before* accounting for any expenses or income relating to the equipment amounts to C 300 000.

The tax authorities grant a tax allowance of 33.3% per annum on the straight line basis in relation to this equipment. The normal tax rate is 30%. There are no other permanent or temporary differences other than those evident from the information provided.

Required:

a) To the extent of the information available, prepare extracts from the statement of comprehensive income, statement of financial position and notes to the financial statements of Wanderers Limited for the June 20X3 financial year in accordance with International Financial Reporting Standards.

Accounting policies and comparatives are not required.

b) To prepare the journal entry to account for the change in the recoverable amount of the equipment at 30 June 20X3.

Part B

The ***same situation*** applies as in Part A above, except that management of Wanderers Limited decide to adopt the following accounting policy relating to equipment:

'Equipment is carried at its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Depreciation is provided at 20% per annum on the straight line basis.'

Details regarding this equipment follow:

- At 30 June 20X1, significant changes in technology by competitors led management to assess the recoverable amount of the equipment. The fair value less costs to sell was estimated at C 440 000 and the value in use was determined to be C 380 000.
- Towards the end of the 20X3 financial year, it became apparent that the competitors' new technology developed in 20X1 was not commercially viable. The fair value, as determined by an independent valuator amounted to C 500 000. The recoverable amount is C 520 000.
- The estimated useful life has remained unchanged throughout. The residual value is estimated to be nil (unchanged).

Required:

Prepare the journal entries to account for the equipment for the years ending 30 June 20X1 and 30 June 20X3 assuming that the net replacement value method is used.

Part C

The ***same situation*** applies as in Part A above, except that management of Wanderers Limited decide to adopt the following accounting policy relating to equipment:

'Equipment is carried at its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Depreciation is provided at 20% per annum on the straight line basis.'

Details regarding this equipment follow:

- At 30 June 20X1, the fair value of the equipment as determined by an independent valuator amounted to C 440 000
- Towards the end of the 20X3 financial year the fair value of the equipment as determined by an independent valuator amounted to C 500 000.
- The estimated useful life has remained unchanged throughout. The residual value is estimated to be nil (unchanged).

Required:

Prepare the journal entries to account for the equipment for the years ending 30 June 20X1 and 30 June 20X3 assuming that the net replacement value method is used.

Question 10.14

Curious Limited has a year end of 31 December. The accountant would like you to explain and / or calculate the following:

a) **IAS 16: terms**
Explain the difference between the cost model and the revaluation model, and what the terms actually refer to.

b) **IAS 16: revaluation model - increase in value; ignoring tax**
Plant cost C 100 000 on 1/1/20X1. Depreciation is provided at 20% per annum on the straight-line basis. The fair value is C 90 000 at 1/1/20X2. The residual value is assessed to be zero and this has remained unchanged since acquisition. The company wishes to transfer the realised portion of the revaluation surplus to retained earnings annually.

i. Calculate and journalise the change in value of the plant.

ii. Calculate and journalise the depreciation of the plant for 20X2.

iii. Calculate and journalise the amount of the transfer from the revaluation surplus to retained earnings and explain why the company makes this transfer.

c) **IAS 16: revaluation model - increase in value; with tax**
Same information as in (b) above, except that there is a tax allowance of 20% per annum on the straight-line method and that the applicable tax rate is 30%.

d) **IAS 16: revaluation model - decrease in value; ignoring tax**
Plant cost C 100 000 on 1/1/20X1. Depreciation is provided at 20% per annum on the straight-line basis. The fair value is C 70 000 at 1/1/20X2. The residual value is assessed to be zero and this has remained unchanged since acquisition. The company wishes to transfer the realised portion of the revaluation surplus to retained earnings annually.

i. Calculate and journalise the change in value of the plant.

ii. Calculate and journalise the depreciation of the plant for 20X2.

iii. Calculate and journalise the amount of the transfer from the revaluation surplus to retained earnings and explain why the company makes this transfer.

e) **IAS 16: revaluation model - decrease in value; with tax**
Same information as in (d) above, except that there is a tax allowance of 20% per annum on the straight-line method and that the applicable tax rate is 30%. Show all journals.

f) **IAS 16: revaluation model – impairment; ignoring tax**
Plant cost C 100 000 on 1/1/20X1. Depreciation is provided at 20% per annum on the straight-line basis. The recoverable amount is C 70 000 at 1/1/20X2. The residual value is assessed to be zero and this has remained unchanged since acquisition. The company transfers the realised portion of the revaluation surplus to retained earnings annually.

i. Calculate and journalise the change in value of the plant.

ii. Calculate and journalise the depreciation of the plant for 20X2.

iii. Calculate and journalise the amount of the transfer from the revaluation surplus to retained earnings and explain why the company makes this transfer.

g) **IAS 16: cost model - increase in value; ignoring tax**
Same information as in (b) above, except that the company uses the cost model and the C 90 000 is the recoverable amount at 31 December 20X1.

h) **IAS 16: cost model - decrease in value; ignoring tax**
Same information as in (f) above, except that the company uses the cost model and the C 70 000 is the recoverable amount at 31 December 20X1.

i. Calculate and journalise the change in value.

ii. Calculate and journalise the depreciation of the plant for 20X2.

The revaluation model is applied using the net replacement value method.

Question 10.15

Maroon Limited has plant that cost C 100 000 on 1/1/20X1. Depreciation is provided over the useful life of 5 years on a straight line basis to a nil residual value. The company uses the revaluation model for subsequent measurement of its property, plant and equipment and accounts for revaluations on the net replacement value method.

- The fair value, as assessed by an independent valuator at 1/1/20X2 amounts to C 120 000
- The fair value, as assessed by an independent valuator at 1/1/20X3: amounts to C 50 000
- The fair value, as assessed by an independent valuator at 1/1/20X4: amounts to C 50 000

The company transfers the maximum amount possible from the revaluation surplus to retained earnings on an annual basis.

Impairment testing at the end of each year found that the recoverable amounts were higher than carrying amounts.

Required:

Calculate and journalise the transactions for the years ended 31 December 20X2, 20X3 and 20X4.

Ignore tax.

Question 10.16

Carryon Limited produces widgets. The following information relates to its plant:

- The plant originally cost C 1 000 000 when purchased on 1 January 20X8. Plant is depreciated on the straight-line basis over 5 years to a nil residual value.

- Plant was revalued to fair value (determined with reference to an active market), by Mr. Pernickity, an independent appraiser and member of the Institute of Valuers:

  - On 1/1/20X9 to *net* replacement value of C 900 000
  - On 1/1/20Y0 to *net* replacement value of C 500 000

- The company adopted the revaluation model and accounts for the revaluation on the net replacement value basis.

- The company transfers the maximum from the revaluation surplus to retained earnings on an annual basis. The company intends to keep the asset.

- The residual value of plant has remained unchanged since acquisition.

- Impairment testing at the end of each year found that the recoverable amounts were higher than carrying amounts.

Required:

Part A: *Ignoring tax:*

i) Journalise all related transactions for the years ending 31 December 20X8, 20X9 and 20Y0.

ii) Prepare the statement of changes in equity for the year ended 31 December 20Y0 in accordance with International Financial Reporting Standards.

iii) Prepare the Property, Plant and Equipment note for the year ended 31 December 20Y0 in accordance with International Financial Reporting Standards:

Comparatives are not required.

Part B: *Assuming the following information regarding tax:*

- The tax authorities grant an allowance on plant at 20% on cost;
- The normal corporate tax rate is 30% throughout; and
- There are no permanent or temporary differences other than those evident from the information presented above.

i) Journalise all related transactions for the years ending 31 December 20X8, 20X9 and 20Y0.

ii) Prepare the statement of changes in equity for the year ended 31 December 20Y0 in accordance with International Financial Reporting Standards.

iii) Prepare the following notes for the year ended 31 December 20Y0 in accordance with International Financial Reporting Standards:

- Property, plant and equipment
- Taxation
- Deferred taxation

Comparatives are not required.

iv) Disclose the closing balance of plant in the Property, plant and equipment note for the year ended 31 December 20Y0 assuming that the gross replacement value method had been adopted. The comparative year's closing balance need not be disclosed.

Question 10.17

Midway Limited has always revalued their assets to fair values (based on future income) on a two-yearly cycle using the *net replacement value* method. The following information relates to their specialised vehicles:

	C
Original cost (1/7/20X5)	500 000
Net replacement value (1/1/20X7)	420 000
Net replacement value (1/1/20X9)	165 000

Depreciation is provided on the straight-line method to a nil residual value, over an estimated useful life of five years.

Neither the estimated useful life nor the residual value was changed at any stage. The realised portion of the revaluation surplus is transferred annually to retained earnings.

There were no indicators of impairment at any stage of the year.

Required:

Part A *Ignoring tax:*

i) Journalise the above transactions from date of original purchase to 31 December 20X9.

ii) Prepare, for the year ended 31 December 20X9, in accordance with International Financial Reporting Standards:
- The statement of changes in equity
- The profit before taxation note
- The property, plant and equipment note

Accounting policies are not required.

Part B *Assume the following additional information relating to tax:*

- The tax authorities grant an allowance on vehicles at 20% on cost (apportioned for part of a year where appropriate);
- There are no other temporary or permanent differences other than those apparent from the information given; and
- The normal corporate tax rate remained 30% throughout.

i) Journalize the above transactions from date of original purchase to 31 December 20X9.

ii) Prepare, for the year ended 31 December 20X9, in accordance with International Financial Reporting Standards:

- The statement of changes in equity
- The profit before taxation note
- The property, plant and equipment note
- The taxation note
- The deferred taxation note

Accounting policies are not required.

Question 10.18

Greenhouse Limited is a small company listed on the Alt X Exchange. It manufactures specialist components for satellite navigation to monitor carbon emissions in the atmosphere. The year-end of the company is 30 June.

The company purchased an item of plant on 1 July 20X5. It was installed and available for use in the manner intended by management on the same day. The cost of the plant was C 900 000. It has an estimated useful life of four years and no residual value. The tax authorities allow a tax allowance of 25% per annum.

Greenhouse Limited uses the revaluation model for the measurement of its property, plant and equipment and due to the nature of its operations; the company has a policy of revaluing its property, plant and equipment on an annual basis. The net replacement value method is used. The company transfers the revaluation surplus to retained earnings as the asset is used.

The fair value of the plant was estimated using discounted cash flows by an independent valuer at 30 June 20X6 and 30 June 20X7 as shown in the following table. The useful life and residual value remained unchanged.

Date	Fair value
30 June 20X6	C 825 000
30 June 20X7	C 400 000

The profit before tax has been correctly calculated at C 300 000 for the year ended 30 June 20X7.

There were no indicators of impairment at any stage during the year.

The corporate tax rate is 29% and has not changed since the plant was purchased. There are no permanent or temporary differences other than those apparent from the information given.

Required:

a) Prepare all the journal entries relating to the plant for the year ended 30 June 20X6

b) Prepare relevant extracts from the statement of comprehensive income and statement of changes of equity of Greenhouse Limited for the year ended 30 June 20X7 and relevant extracts from the statement of financial position at 30 June 20X7.

c) Prepare relevant extracts from the notes to the financial statements of Greenhouse Limited at 30 June 20X7.

The *accounting policy for property, plant & equipment is required.*

Accounting policies for statement of compliance, basis of preparation and deferred taxation are not required.

Comparatives are not required

Question 10.19

Wimbles Limited is a company producing garden implements. The following information relates to the company's plant:

- The plant originally cost C 600 000 when purchased on 1 January 20X8.
- Plant is depreciated on the straight-line basis over 5 years to a nil residual value. This has remained unchanged since acquisition.
- The plant was revalued by Mr. Wimble, an independent sworn appraiser and a member of the Institute of Valuers, as follows:
  - On 1/3/20X8 to a fair value of C 725 000
  - On 1/3/20X9 to a fair value of C 506 000
- The company adopts the revaluation model and accounts for the revaluation on the net replacement value basis. The maximum amount is transferred from the revaluation surplus to retained earnings on an annual basis. The company intends to keep the asset.
- A tax allowance on the plant is granted at 20% per annum on the straight-line basis, apportioned for time.
- There were no indicators of impairment at any stage during the year.
- The applicable tax rate is 30% throughout. There are no permanent or temporary differences other than those evident from the information presented above.

Required:

a) Journalise all related transactions for the years ending 28 February 20X8, 20X9 and 20Y0.

b) Prepare the statement of changes in equity for the year ended 28 February 20Y0.

c) Prepare the following notes for the year ended 28 February 20Y0 in accordance with International Financial Reporting Standards:

- Profit before tax
- Property, plant and equipment
- Taxation
- Deferred taxation

Comparative figures are required.

Question 10.20

Machines Limited applies the cost model for measurement of its assets. The following information applies to its machinery.

Cost	C 500 000
Purchase date:	1/1/20X1
Useful life	5 years

- Details of the machinery's estimated recoverable amount over the years is as follows:

	C
31/12/20X1:	420 000
31/12/20X2:	280 000
31/12/20X3:	250 000
31/12/20X4:	85 000
31/12/20X5:	0

The tax authorities allow tax depreciation at 20% per annum on the straight-line method. The tax rate remained 30% throughout. There are no other temporary or permanent differences other than those mentioned above.

Residual values over the years were all assessed to be zero and depreciation is provided using the straight-line method over its useful life. This has remained unchanged since acquisition.

Required:

a) Show the journal entries for each of the years ended 31 December.

b) Prepare extracts from the statement of financial position and notes to the financial statements in accordance with International Financial Reporting Standards.

Question 10.21

Raingo Limited applies the cost model to its plant, details of which follow:

Cost	C 100 000
Purchase date:	1/1/20X1
Useful life	5 years

- Details of the machinery's estimated recoverable amount over the years is as follows:

	C
31/12/20X1:	70 000
31/12/20X2:	65 000
31/12/20X3:	30 000

- All residual values are assessed to be zero and this has remained unchanged since acquisition.

- Depreciation is provided using the straight-line method over its useful life.

- The drop in the plant's value at the end of 20X3 was due to damage caused during a riot on the factory premises in 20X3. Similar damage was caused during a similar riot in 20X1. The damage incurred during the 20X1 riots was repaired in 20X2.

- The company has pledged the plant as security for a loan. Details of the loan will be provided in note 6 of the notes to the financial statements for the year ended 31 December 20X3.

- The company directors signed a contract involving the construction of a plant to be completed by April 20X4 at an expected cost to the company of C 500 000. Since construction had not yet begun at year-end, a liability for this amount has not yet been recognised.

Part A:

Required:

a) Show the journal entries for each of the three years ended 31 December 20X3.

b) Disclose the above in the notes to the financial statements for the year ended 31 December 20X3 in accordance with International Financial Reporting Standards.

Ignore tax.

Part B:

The tax authorities:

- allow a deduction for tax purposes of 20% of the cost of the asset per annum;
- levy normal corporate income tax at 30%.

There are no temporary or permanent differences other than those mentioned above.

Required:

a) Show the journal entries for each of the three years ended 31 December 20X3.

b) Disclose the above in the notes to the financial statements for the year ended 31 December 20X3 in accordance with International Financial Reporting Standards.

Question 10.22

Values Limited uses the revaluation model and has a policy of revaluing their assets to fair values on a two-yearly cycle using the *net replacement value* method. The company has a 31 December year end.

Plant was purchased on 1 May 20X5 at a cost of C 450 000. It has a useful life of five years with no residual value.

At 31 December 20X6, an impairment test found the plant's recoverable amount to be C 220 000. There is no change to the expected useful life or residual value of the asset.

At 31 December 20X8, the plant was re-valued by an independent valuer to a fair value of C 190 000. The recoverable amount on this date is C 205 000. There is no change in the expected useful life or residual value of the asset. The revaluation surplus is transferred to retained earnings over the remaining estimated useful life of the asset.

Depreciation is provided on the straight-line method over the plant's estimated useful life.

Profit before tax has been correctly calculated at C 800 000 in 20X9 and C 600 000 in 20X8.

The tax authorities allow tax depreciation at 20% on the straight-line basis apportioned for time. There are no other temporary or permanent differences other than those apparent from the information given. The tax rate remained 30% throughout.

Required:

a) Journalise the above transactions from date of original purchase.

b) Prepare the statement of comprehensive income for the year ended 31 December 20X9.

c) Prepare the statement of changes in equity for the year ended 31 December 20X9.

d) Prepare the following notes for the year ended 31 December 20X9 in accordance with International Financial Reporting Standards:

- Profit before taxation
- Taxation
- Property, plant and equipment
- Deferred taxation

Comparatives are required

Accounting policies are not required.

Question 10.23

Able Limited purchased all its plant on 1 January 20X1 and re-values it every four years. Revaluations have been performed by Trust Valuers, an independent firm of valuers, as follows:

- 1 January 20X5: C 8 000 000
- 1 January 20X9: C 9 000 000.

The plant is depreciated over an expected useful life of 20 years to a nil residual value.

Required:

Prepare the property, plant and equipment note for 20X9 in accordance with International Financial Reporting Standards using:

a) the gross replacement value method

b) the net replacement value method.

Question 10.24

Cost of plant at 1/1/20X1:	C 200 000
Depreciation:	20% straight-line per annum to a nil residual value

The company re-values its plant on an annual basis and records the fair value adjustments using the net replacement value basis. The following revaluations were performed:

- Fair value at 1/1/20X2 is C 180 000
- Fair value at 1/1/20X3 is C 108 000
- Fair value at 1/1/20X4 is C 88 000

The company intends to keep the plant. There has never been any evidence of an impairment. There are no other items of property, plant or equipment.

The tax authorities allow tax depreciation at 20% per annum straight-line. The normal income tax rate is 30%.

There are no temporary differences other than those evident from the information provided.

There are no components of other comprehensive income other than that which is evident from the information provided. The company shows components of other comprehensive income *net of tax*.

Profit for each year is C 200 000 (after tax).

Required:

Disclose the plant and all related information in the financial statements for the years ended 31 December 20X1, 20X2, 20X3 and 20X4 in accordance with the International Financial Reporting Standards.

Question 10.25

The following costs were incurred by Travelling Ill Berry Limited during the construction of a new factory plant in 20X1:

- Raw materials: C 400 000 was purchased from external suppliers and C 200 000 was purchased from an internal division at a 25% mark-up on cost

- Labour costs: C 500 000 payments were made to the labourers (i.e. after deductions of C 300 000 in respect of employee contributions to provident funds and medical aids and after deduction of employee's tax of C 200 000; TIB Limited contributes an equivalent amount to the funds as do the employees).

- Specialised platform: a specialised platform had to be created for the factory plant. This platform was constructed by subcontractors at a cost of C 750 000. It has a useful life of 10 years and a residual value of C 50 000.

- Safety inspection: a safety inspection is required by law before production could begin. The first inspection was performed on 1 June 20X1 at a cost of C 600 000. Inspections will be necessary for the continued operation of the plant every 3 years.

- A launch party: a party to celebrate the opening of the factory was held on 5 June 20X1 at a cost of C 100 000.

- Damages: an engine failed on 29 December 20X1 and had to be replaced. The cost of the original engine was estimated at C 100 000 (considered to be material). The original engine was scrapped. A replacement engine was purchased and fitted on 30 December 20X1 at a cost of C 110 000. Due to the unexpected failure, the new engine is now depreciated over a useful life of 2 years (residual value: nil).

- The factory plant is expected to have a useful life of 20 years (the specialised platform will need to be replaced during this period) and is expected to have a nil residual value. The straight-line method is considered to be the most appropriate for the plant.

- The plant was available for use on 2 June 20X1 and was brought into use on 1 July 20X1.

- The plant will need to be dismantled after 20 years at an expected future cost of C 3 000 000. An appropriate discount rate is 10%.

- Day to day maintenance costs: C 20 000 per month was incurred on a subcontracting company that provided full maintenance of the plant.

Required:

Calculate the carrying amount of the plant in Travelling Ill Berry Limited's Statement of Financial Position as at 31 December 20X1 in accordance with International Financial Reporting Standards.

Part 3

Chapter 11
Intangible assets

Question	Key issues
11.1	Short questions relating to: identity, control and measurement
11.2	Treatment of license
11.3	Treatment of research and development costs
11.4	Trademark – definition and recognition criteria, initial recognition, subsequent measurement and subsequent valuation
11.5	Research costs compared to development costs
11.6	Brand name
11.7	Measurement of purchased brand name, limited legal life renewable at insignificant cost
11.8	Measurement of purchased brand name, limited legal life renewable at significant cost
11.9	Journal entries
11.10	Purchased compared to internally generated brand, research and development costs, useful life of patent
11.11	Recognition and measurement of catalogues

Question 11.1

The following scenarios are all *un*related.

Part A
Apple Limited is a successful engineering business. Over the past number of years, the company has achieved a market share for its products of 30%. At a recent board meeting, the directors suggested recognising an intangible asset for this market share.

Required:

To briefly discuss whether the market share can be recognized as an intangible asset in terms of IAS 38, *Intangible Assets.*

A discussion of the recognition criteria is not required.

Part B
Banana Limited is a company in the IT industry. The success of the company is built around software which it has developed internally and for which a patent is registered *as well as* the skills of the staff that operate the software. Staff is required to give one month's notice of their resignation.

Required:

To briefly discuss whether the patent *and* the staff skills can be recognized as an intangible asset in terms of IAS 38, *Intangible Assets.*

A discussion of the identifiability criteria is not required.

Part C
Carrot Limited manages and operates toll roads on major national routes throughout the country. The company purchased a license to operate a toll road in the Eastern Cape seventeen years ago for an amount of C 10,000,000. It was expected that the toll road would be in use for twenty years and the economic benefits will flow to the entity *evenly* over the twenty year period. The estimated toll road usage is 1,000,000 cars per year. At the time, there were no plans to construct alternative routes in the area. There is no active market for toll road licenses.

During the current year, the government announced plans, and construction began on a bridge in the area that would significantly reduce usage of the toll road. The directors estimated that the economic benefits flowing to the entity would *decrease* each year over the remaining three years. The estimated toll road usage is expected to drop to 800 000 cars, 600 000 cars and 400 000 cars, respectively, over the remaining three years of the license.

The right to operate the toll road was correctly recognized as an intangible asset upon purchase seventeen years ago.

Required:

To discuss the accounting issues relating to the *measurement* of the license for the toll road over its economic life.

Question 11.2

Hurtigruten Limited is a small company involved in the fishing industry. It operates a number of fishing boats and fishes mainly for tuna. The fish is processed and canned in its factory and the canned tuna is supplied to supermarkets around the country.

On 2 January 20X6 the company acquired a fishing licence at a cost of C600 000. The license has a legal life of four years with no residual value. The licence grants Hurtigruten Limited the right to fish for tuna in a demarcated area off the Western Cape coast. No other fishing company may fish for tuna in this area during the term of the licence.

The financial director, a retired accountant, expensed the cost of the fishing licence on acquisition. The managing director (who has taken a keen interest in IFRS developments) has queried the expensing of the fishing licence:

No entries have been made in the accounting records relating to the fishing license during the current year.

Required:

Discuss the recognition, measurement and disclosure of the fishing license in the financial statements of Hurtigren Limited at 31 December 20X6, in terms of International Financial Reporting Standards.

Question 11.3

Quencher Limited's business involves the bottling and distribution of a wide variety of carbonated soft drinks. Some drinks are developed internally, whilst other brands are purchased. The following information is relevant to the business for the year ended 30 May 20X5.

N-Gee:

- On 1 April 20X5, Quencher acquired the well known brand, N-Gee for an amount of C2 500 000, which was paid in full at that date.
- In addition to this, an amount of C175 000 was spent on legal fees to secure the right to use this brand. The legal fees were paid on 31 April 20X5.
- Due to the fact that Quencher's staff had never previously been exposed to N-Gee, extensive training (by the staff at the company from whom the N-Gee brand had been purchased) took place during the month of April 20X5. The total cost of this training amounted to C200 000.
- Sales of N-Gee drinks commenced on 15 May 20X5.
- The N-Gee brand has an estimated useful life of fifteen years.

Fliptop:

Fliptop is a revolutionary type of can which has been developed internally by Quencher over the past two years. The can has a re-sealable top which allows the can to be sealed after opening to prevent the gas escaping. In January 20X4 the idea for this new product was launched, and a loan of C5million was obtained from Borrow Bank in order to finance this project.

Question 11.4

You are the auditor of a number of small companies and have been asked to advise Food Limited on how to deal with the following transaction.

Food Limited is a fast-food company. In order to facilitate expansion, Food Limited purchased 100% of another successful food company. The purchase negotiations were settled during the year as follows:

- The total purchase price for the business amounted to C40 000.
- The net tangible assets acquired were stipulated in the purchase agreement at their fair value of C19 500.

Although the purchase agreement stipulated that Food Limited also acquired the legal rights to a trademark for a period of 22 years, no value was attached thereto. The reason is that the trademark was internally generated by the seller and was thus not recognised in the seller's financial statements, despite it having been a most profitable trademark for many years.

- **Initial Recognition:** Food Limited intends to record the purchased trademark in its financial statements at C20 500, calculated as follows:

	C
Purchase price	40 000
Less net tangible assets	19 500
Trademark	20 500

- **Amortisation:** Food Limited is unsure whether or not to amortise the trademark since it believes that the trademark is so profitable that it has an indefinite useful life.
- **Impairment testing and revaluing to fair values:** Food Limited intends to revalue the trademark annually using the revaluation model.

Required:

Discuss the proposed accounting treatment of the trademark in the financial statements of Foods Limited. Your discussion should be set out under the following sub-headings:

a) Definitions and recognition criteria relevant to the acquisition of the trademark

b) Initial recognition

c) Amortisation

d) Impairment testing and revaluing to fair values

Question 11.5

The accounting treatment of research costs differs from that of development costs.

Required

Discuss, with reference to both the Framework and IAS 38, Intangible Assets how and why the accounting treatment of research costs differs from that of development costs

A discussion of the circumstances under which research and development may be capitalised, should be included in your discussion.

Question 11.6

Yoyo has, for many years, manufactured a yoghurt drink called 'Yog-Nog'. This brand name was originally acquired 10 years ago from a competitor company. The cost of this acquisition came to C800 000, which was duly capitalised. No amortisation had been processed against this brand name since the brand was already 80 years old at the time of acquisition and, at that time, there was no indication that demand for this drink was diminishing.

Sales of Yog-Nog have, in recent times, been falling. The marketing department, after much research into the related consumer behaviour, suggested that the fall in sales was related to the outdated brand name of the drink. The suggestion was accepted and the drink was re-launched as 'Yogi-Yippi' during late December 20X10. The cost of re-launching the drink came to C450 000 and was capitalised as a Yogi-Yippi Brand name since it was expected that sales would now improve.

The previous brand name, 'Yog-Nog', with a carrying amount of C800 000, was expensed in full in the current year ended 31st December 20X10.

Required:

Critically analyse the above issue, explaining whether the treatment is correct or incorrect and justifying your advice with reference to International Financial Reporting Standards.

Question 11.7

Mince Limited is a company manufacturing and retailing food products. The current financial year ends on 31 December 20X3. The company owns one brand name, 'pie', shown in the balance sheet at its carrying amount of C300 000. The right to manufacture under this brand name for a period of 30 years was purchased on 1 January 20X0 for C300 000. These rights may be renewed at a cost of C10 000 (an immaterial cost to the company). The brand name is considered to have an indefinite useful life. Mince Limited intends not to calculate the recoverable amount of this brand at 31 December 20X3 since a detailed calculation of the recoverable amount was done at the end of 20X2 on which date there was an immaterial difference between the recoverable amount and carrying amount and there appears to be no indication of an impairment after having performed the indicator review.

Required:

Critically analyse the measurement of 'Pie' in the financial statements of Mince Limited.

Question 11.8

Goo Limited owns a brand 'gobblers', to which legal rights for a 25-year period were purchased on 1 January 20X1 for C500 000, renewable at a further cost of C1 000 000. The 'gobblers' brand is reflected in the balance sheet at its carrying amount of C500 000.

A review of past figures makes it clear that the profits from the brand 'gobblers' are diminishing dramatically. At the time of the purchase, it was estimated that this brand would render annual profits of C80 000 and at that time, it appeared so successful that its useful life appeared to be indefinite. The budgeted profit figures presented at the end of the 20X2 financial period indicated a slight (immaterial) dip in future expected profits, but taken together with the latest budgeted profits presented at a directors meeting on 29 December 20X3, makes it clear that these annual profits of C80 000 are on a downward spiral.

These latest budgeted figures show a total estimated net cash inflow of C70 000 over the remaining legal life. Goo Limited has the option to dispose of this brand to a local businessman who has recently (December 20X3) offered to purchase it for C220 000. The only selling costs that are expected will be C2 000 in legal fees. The current financial year ends on 31 December 20X3.

Required:

Critically analyse the measurement of the 'gobblers' brand in the financial statements of Goo Limited.

Question 11.9

Ozone Limited has been working on a project to develop a chemical that can be released into the atmosphere to break the greenhouse gases into gases that are less damaging to the environment.

The accountant is aware that C1 500 000 has been incurred, and paid for, between 20X1 and 20X4 but he has been told by the auditors that the manner in which he has accounted for these costs is incorrect and that given the significant amounts involved, that they would have to qualify the report if it was not corrected. The auditors had already indicated he should correct this a month ago but he had not done so, since he had lost the original detail provided to him by the chief scientist.

Question 11.10

Beehive Limited is a company that owns a number of intangible assets. A list of the intangible assets owned by Beehive Limited together with some detail is provided below:

- A brand called 'Orange blossom'. This brand was acquired on 1 April 20X6 for C2 000 000. The life of the 'Orange blossom' brand is expected to be ten years. There is no active market for this brand.

- A brand called 'Infused ginger'. This brand has been developed by Beehive Limited during 20X6 at a cost of C300 000 (incurred in May 20X6). The life of the 'Infused ginger' brand is expected to be ten years. There is no active market for this brand.

- A lollipop that can be used as a flashlight in the dark is currently being developed. The initial research into the technical feasibility of this product and its potential market cost C800 000 during 20X4. Development began on 1 March 20X4 and has cost Beehive Limited a total of C34 000 000 to 31 December 20X6. All criteria were met for capitalization of development costs in 20X4. Throughout 20X5, cash flow problems resulted in Beehive Limited being unsure of their ability to continue the development of this prototype. The cash flow problems were resolved in early January 20X6 with the securing of a loan liability from Dodge Bank. Development costs were incurred evenly over the three years.

- The right to manufacture under a patent for a period of five years was purchased on 1 September 20X6 for C5 000 000. The patent has an expected life of twenty years. This patent may be renewed for a further period of three years for a sum of C30 000.

Required:

a) *Briefly compare* aspects of the recognition and measurement of each of the two brands, Orange blossom and Infused ginger. Your answer should consider:

   i) Recognition: Infused ginger Brand versus Orange blossom Brand
   ii) Measurement: residual value for purposes of amortising the Infused ginger Brand and Orange blossom Brand
   iii) Measurement models: Infused ginger Brand versus Orange blossom Brand
   iv) Journal entries: show the journal entries (relating to both brands) that would have been processed during 20X6

b) *Briefly discuss* aspects of the recognition and measurement of the research and development of the lollipop flashlight in the financial statements of Beehive Limited. Your discussion should consider:

   i) Recognition: research versus development of the flashlight lollipop in each of its years ended 31 December 20X4, 20X5 and 20X6
   ii) Measurement: amortization and impairment testing of research versus development of the flashlight lollipop

c) *Discuss* the determination of useful life for the purpose of amortising the patent in the financial statements of Beehive Limited for the year ended 31 December 20X6.

Question 11.11

Part A
Alastair's Natural Remedies Limited is a retailer of health products, including vitamins and supplements. The company orders 12 000 catalogues to advertise its products. These catalogues are receive from the printers on 15 September 20X8 and are to be distributed to customers evenly from 1 September 20X8 to 15 December 20X8, as a promotional activity for the holiday season.

The catalogues have a cost of C2 each. The amount owing to the printer will be settled in 30 days from delivery of the catalogues.

Alastair's Natural Remedies Limited has a financial year end of 30 September.

***Required*:**

Discuss the recognition and measurement of the cost of the catalogues in the financial statements of Alastair's Natural Remedies for the year ended 30 September 20X8.

Part B
Same information as in Part A, except:

- the amount owing to the printer has been paid in advance on 15 August 20X8, when the order was placed.
- Alastair's Natural Remedies Limited has a financial year end of 30 August.

***Required*:**

Discuss the recognition and measurement of the cost of the catalogues in the financial statements of Alastair's Natural Remedies for the year ended 31 August 20X8, in terms of IAS 38, Intangible Assets.

Part 3

Chapter 12
Investment properties

Question	Key issues
12.1	Short questions – big picture on investment properties
12.2	Discussion: property held for more than one use
12.3	Change in use: journals and basic theory
12.4	Change in use: journals and basic theory
12.5	Change in use: disclosure
12.6	Cost model (purchased with subsequent expenditure) and fair value model: journals and disclosure
12.7	Fair value model: journals with deferred tax effect
12.8	Change in use and joint use properties: discussion in a letter format
12.9	Classification involving joint use properties and measurement involving choice of models: discussion
12.10	Joint use properties: discussion

Question 12.1

a) Explain the difference between an investment property and an owner-occupied property.

b) What are the two models allowed for investment properties and briefly explain how these two models compare to the two models allowed for property, plant and equipment.

c) List the four scenarios under which a transfer may be made into investment property or from investment property from/ to another asset.

Question 12.2

Splurge Limited is a dairy company and owns a farm (consisting of 200 hectares including a total of five sheds), which it purchased for C2 000 000. Splurge Limited uses the farm for the following:

- one stand-alone shed is used for the milking of Splurge Limited's cattle;
- 40 hectares surrounding the stand-alone shed is used for grazing for Splurge Limited's dairy cattle; and
- the remaining 160 hectares of land and four other sheds are let to fellow farmers for grazing of their own cattle and storage of fodder. The leases are non-cancellable operating leases.

The 160 hectares of land together with the four sheds was purchased by Splurge five years ago and has a separate title deed to the other 40 hectares (including the stand-alone shed).

Required:

Discuss how Splurge Limited should account for the farm in the financial statements in terms of International Financial Reporting Standards. You may assume that Splurge Limited intends to keep the farm in its existing use for the foreseeable future.

Ignore tax.

Question 12.3

Owlface Limited owns two buildings:

- a head office building located in Quetta; and
- another office building located in Karachi.

The office building located in Quetta is used as Owlface Limited's head office. A minor earthquake, on 30 June 20X5, destroyed this building.

- The building in Quetta was purchased on the 1 January 20X5 for C1 200 000 (total useful life: 10 years and residual value: nil).

The property in Karachi was leased to a tenant, Spider Limited. After the earthquake, Owlface Limited urgently needed new premises for its head office. Since Spider Limited was always late in paying their lease rentals, Owlface Limited decided to immediately evict them and move their head office to this building situated in Karachi.

- The building in Karachi was purchased on the 1 January 20X5 for C500 000.
- On the 30 June 20X5, the fair value of the building in Karachi was C950 000.
- There was no change in fair value at 31 December 20X5.
- The total useful life was estimated to be 10 years from date of purchase and the residual value was estimated to be nil.

Owlface Limited uses:

- The cost model to measures its property, plant and equipment; and
- The fair value model for its investment properties.

Required:

a) Journalise the above transactions in the books of Owlface Limited for the year ended 31 December 20X5. Ignore tax.

b) Define 'investment property' and 'owner-occupied property'.

c) Define fair value and explain how it is calculated.

Question 12.4

Chattels Chief Limited owns an office block.

- Chattels Chief Limited had occupied the office block from date of purchase until 30 June 20X5.
- The office block had cost C1 000 000 on 1 January 20X4.
- Its residual value is estimated to be nil and total useful life is estimated to be 10 years respectively (both estimates have remained unchanged).
- On 30 June 20X5, Chattels Chief Limited moved out of the office block and thereafter rented it to tenants under short-term operating leases.
- The fair value of the office block was equal to its carrying amount on 30 June 20X5.
- The fair value of the office block was C800 000 on 31 December 20X4 and C1 500 000 on 31 December 20X5.

Chattels Chief Limited measures owner-occupied property using the cost model and investment property using the fair value model.

Required:

a) Show all journals relating to the office block in the books of Chattels Chief Limited for the year ended 31 December 20X5. *Ignore tax.*

b) If Chattels Chief Limited leases its office block to one of its subsidiary companies, explain how the office block must be measured in:

    - Chattels Chief Limited's financial statements; and
    - the group financial statements.

Question 12.5

Snake Limited is in the construction industry. It constructs buildings for resale, for leasing and for private use.

- A building that Snake Limited had constructed in *Islamabad* (at a cost of C1 000 000) had been on the market for 2 years and was still not sold. On 1 March 20X5 Snake Limited took it off the market and leased it instead. It was leased on 1 March 20X5. Its fair value was C1 500 000 on 31 December 20X5 and C1 000 000 on 31 December 20X4.

- The fair value of a building in *Balochistan* (rented out to tenants) has never been determinable. This building was completed on 1 January 20X2 at a cost of C5 000 000. Its total estimated useful life is 10 years and its residual value is C1 000 000. Both estimates have remained unchanged.

- On 30 September 20X5, Snake Limited evicted the tenants from a building in *Karachi* and moved its head office into the building instead. On this day, the fair value was C4 000 000, the remaining useful life was 5 years and the residual value was C500 000. The fair value of this building was C3 000 000 on 31 December 20X4.

- On 30 September 20X5, Snake Limited leased out the old head office building in *Lahore*. The original cost was C4 000 000 (acquired on 30 September 20X3), on which date the total useful life was 10 years and its residual value was nil. The fair value was C3 700 000 on 31 December 20X5. The fair value on 30 September 20X5 was equal to its carrying amount.

- Rentals earned from the investment properties totalled C2 000 000.

- Rates paid totalled C1 000 000.

- Snake Limited applies the fair value model to its investment properties and the cost model to its property, plant and equipment.

Required:

Show the investment property note and the profit before tax note in Snake Limited's financial statements for the year ended 31 December 20X5.
Ignore tax and comparatives.

Question 12.6

Tromp Limited is an investment company that purchases buildings and holds them for a number of purposes, such as resale, leasing and its own use.

Tromp Towers

- On 1 January 20X4, Tromp Limited purchased an old building for C300 000. Conveyance's fees amounted to C20 000.

- This building has always been fully let out.

- This building is situated in an isolated part of Balochistan and there is no development anywhere nearby. As a result there is no market for buildings in this area and therefore a fair value is not reliably ascertainable.

- On 31 July 20X4, the directors decided to repaint the building. The repainting was done at a total cost of C50 000.

- This building has never had an air-conditioning system. After numerous complaints from tenants about not being able to tolerate the Balochistan heat, Tromp Limited decided to upgrade the building by installing a ducted air-conditioning system on 1 October 20X4.

- The cost of installation included the following:

	C
Adjustments to the structure of the building	30 000
Air-conditioning units	200 000
Installation costs	50 000

- On 31 December 20X4, a huge property boom took place in the area, with the result that the fair value of Tromp Towers could now be determined. Tromp Limited does not, however, wish to change their policy of measuring investment property using the cost model.

- The building has a 10 year useful life and a nil residual value.

- The ducted air-conditioning system has a 10 year life and a nil residual value.

Tromp Limited also holds other investment property, all of which are carried under the fair value model. The fair values are as follows:

	C
1 January 20X4	1 000 000
31 December 20X4	1 250 000

Required:

a) Journalise the entries that would arise from the above information for the year-ended 31 December 20X4.

b) Disclose the investment property note for the year-ended 31 December 20X4.

Ignore tax.

Question 12.7

DCS Limited owns two buildings, each with a different purpose:

- The Poplar; and
- The Palms.

The Poplar:

- DCS Limited had purchased this building on 31 July 20X4 for C500 000 cash.
- The Poplar is a high rise building in the centre of Karachi's central business district. This building is leased out to corporate clients.
- Its fair values are as follows:

31 December 20X4	C600 000
31 December 20X5	C700 000
31 December 20X6	C750 000

The Palms:

- On 2 January 20X5, DCS Limited bought this property for C200 000 in cash.
- Although no tenants would rent space in this building, DCS Limited identified that the building would be a prime investment as the area around The Palms was being extensively developed. Expectations are that, once this development is completed, this property will attract a very high price, at which time the plan would probably be to sell it. The property is not, however, held as inventory.
- The building's fair values were as follows:

31 December 20X5	C250 000
31 December 20X6	C400 000

Other information:

- The tax authorities allow a deduction of 5% per annum on the cost of both these buildings (not apportioned for part of a year).
- Gain on immovable property is taxed at normal tax rate of 30%. However the sale proceeds of immovable property is restricted to the cost of the property for tax purposes.
- Both buildings, when purchased, were determined to have useful lives of ten years and nil residual values.
- DCS Limited holds all investment property under the fair value model.

Required:

a) Prepare the journal entries to account for The Poplar for years-ended 31 December 20X4, 20X5 and 20X6.

b) Prepare the journal entries to account for The Palms for the years-ended 31 December 20X5 and 20X6.

Question 12.8

Cool Limited had its head office located in Timbuktu. It owned a building nearby that it rented to Homeless Limited.

Unfortunately a tornado on 30 June 20X5 completely destroyed this building. Since Homeless Limited was a valued tenant, Cool Limited decided to lease 60% of the head office to them as a 'replacement'.

Details relating to the head office are as follows:

- purchased on the 1 January 20X5 for C600 000
- total useful life: 10 years (residual value: nil)
- fair values: C800 000 on 30 June 20X5 and C820 000 on 31 December 20X5.
- it is not possible to sell or lease out this 60% portion of the building separately from the rest of the building.

Cool Limited uses:

- the fair value model to measure its investment properties; and
- the cost model to measure its property, plant and equipment.

Required:

Write a letter to the financial director of Cool Limited explaining how the building should be accounted for in the financial statements for the year ended 31 December 20X5. Suggested journals should be included in your letter.

Use a single account to record movements in the head office's carrying amount.

Ignore tax.

Question 12.9

Uncertain Limited owns an office park that it developed during the current reporting period. It is also a lessee in a number of properties held under lease agreements.

Uncertain Limited's head office is situated in the office park in a stand-alone building. The balance of the office park, containing 2 stand-alone properties, is let to tenants under non-cancellable operating leases.

The Chief Executive Officer of Uncertain Limited is unsure how to account for these buildings. He assumes that the cost model would be the cheapest option to implement (as the fair value estimates will not be needed) and have the least impact on the financial statements.

Required:

Discuss how Uncertain Limited should account for these buildings. Discuss whether the Chief Executive Officer's assumptions are correct.

Question 12.10

Gary Limited needs assistance in accounting for some of their properties

Required:

For the following properties discuss how they should be classified and measured in the financial statements of Gary Limited.

a) A block of flats. The first 3 storeys are occupied by Gary Limited and used for administration purposes. The top 3 storeys are vacant but are expected to be leased out in the near future.

b) A motel consisting of 10 rooms. Three of the rooms are used as an office by Gary Limited while the other 7 are rented out. Ancillary services provided to the rooms are not considered significant.

c) Fairvalue Limited, a subsidiary of Gary Limited, is a property dealer. Sales have dropped recently. The directors of Fairvalue Limited have therefore decided to diversify their business. One property, a block of flats, will now be refurbished and leased out under operating leases. Another one of their properties that were previously held for sale, a town house, will now be held for capital appreciation.

Part 3

Chapter 13
Inventories

Question	Key issues
13.1	Accounting policies, basic notes
13.2	Inventory purchases involving discount: journals
13.3	Net realizable values: calculations
13.4	Fixed overheads, value of finished goods, cost and net realizable value
13.5	Cost of inventory with allocation of fixed manufacturing overheads: calculations and journals
13.6	Cost of inventory (including allocation of fixed manufacturing overheads), net realisable value and impairments: calculations, journals and disclosure
13.7	Fixed overheads: calculations of rate, capitalized and expensed portions
13.8	Manufacturing concern: journal entries
13.9	Manufacturing concern: cost of inventory (including allocation of fixed manufacturing overheads), net realisable value and impairments: calculations and disclosure
13.10	Measurement of inventory: short discussions

Question 13.1

The following draft accounting policy notes have been prepared for inclusion in your client's annual financial statements.

- Inventory is valued at the lower of cost and net realisable value.
- Turnover comprises sales to customers and other revenue.

The following matters came to your notice:

- The company is a manufacturing concern that employs a computerised perpetual inventory costing system based on a program which charges out the oldest inventory first. This program was introduced 4 years ago and is running smoothly. For costing and control purposes the variable costing system is used but, for financial reporting purposes, manufacturing overheads are absorbed on the basis of actual production for the year.
- The company's main business is the sale of its finished products. However, it derives other income from commission for introducing customers to a company servicing its products, rental income from sub-letting a portion of its warehouse, and sales from a non-profit-making canteen run for the benefit of the staff.

Required:

a) *Redraft* the statement of accounting policies to comply with good disclosure and reporting practice.

b) *State* what further information would be disclosed in the notes to the financial statements in respect of items dealt with in the statement of accounting policies.

Question 13.2

Details of an acquisition of inventory by Prisma Limited are as follows:

- Goods for resale where all purchased on credit on 1 July 20X9.
- The marked price was C30 000, but a trade discount of C2 000 was successfully negotiated along with an early settlement discount of 20% off the discounted price.
- The settlement discount was offered on the condition that the amount due was paid in full by 31 August 20X9.
- The inventory was paid for on 2 September 20X9 due to cash flow problems.

Required:

Provide journal entries relating to the acquisition of the inventory in Prisma Limited's accounting records.

Question 13.3

Sheikar Limited manufactures 2 product lines: a moisturising lotion and a sun-block. The following information relates to inventory on hand at 31 December 20X8:

Class of inventory	Cost	NRV if sold in present condition	NRV if sold as completed product	NRV
Raw materials	140 000			
Used in moisturising lotion	65 000	60 000	55 000	
Used in sun-block	75 000	60 000	80 000	
Work in progress	95 000			
Moisturising lotion	40 000	30 000	35 000	
Sun-block	55 000	45 000	50 000	
Finished goods	190 000			
Moisturising lotion	90 000	N/A	140 000	
Sun-block	100 000	N/A	80 000	

Required:

Complete the table above for both scenarios (a) and (b) and determine the applicable net realisable value of the different classes of inventory, and the total write down required:

Scenario a) Assume the lifecycle of both the products is coming to an end and the company has decided that it will sell the more profitable class of inventory either in its present condition or converted into a completed product.

Scenario b) Assume that it is the beginning of both of the products lifecycles and the company intends to complete and sell both lines, regardless of profitability.

Question 13.4

Stocky Limited is a manufacturing company and is in its first year of operations. Stocky Limited manufactures one product and has 500 units of finished goods of this product on hand at year-end, (there was neither raw material nor work-in-progress on hand at year-end). The bookkeeper is unsure of how to treat fixed overheads and has left the fixed overhead costs for the year in a suspense account. He has given you the following information:

	Currency	Units
Finished goods (closing balance)	2 500	500
- labour and other conversion costs (C3 per unit)	1 500	
- materials (C2 per unit)	1 000	
Fixed manufacturing overheads suspense account	20 000	
Budgeted sales (12 months)		20 000
Budgeted production (12 months)		40 000
Actual production (12 months)		25 000
Actual sales (12 months)		24 500

The 500 units on hand at year-end were sold for an amount of C3 000 after year-end but before approval of the financial statements.

Required:

a) Calculate the amount at which finished goods will be disclosed in the balance sheet for the first year of operations. Show all your workings.

b) Assuming that:

- the company also had work-in-progress on hand at year-end with a cost of C235 000 (correctly calculated);
- the work-in-progress requires another C12 000 costs to be incurred in order to be completed;
- the product made by the company is fast becoming obsolete; and
- the company plans to complete the work in progress and sell it at a mark-up of 15% on cost (below the usual mark-up) with selling costs estimated at C42 000;

calculate at what value inventories would be shown on the face of the balance sheet for the first year of operations. Show all your workings.

c) Assuming that the company also has raw materials of C20 000 at year-end, which had all been offered as security for a loan, show the disclosure of inventory in the balance sheet as well as the inventory note.

Question 13.5

Junior Unlimited manufactures tinned baby food. Junior Unlimited is in its first year of operations and has estimated that a normal annual production level is 50 000 tins. Junior Unlimited produced 30 000 tins during its first year of operations ended 31 December 20X1. The annual stock count at 31 December 20X1 found 500 tins of finished goods. There is no other inventory on hand at year-end other than these finished goods. The following information relates to the manufacturing costs incurred during 20X1:

• Direct materials purchased	C4 per unit
• Direct labour	C3 per unit
• Variable overheads	C2 per unit
• Fixed overheads	C30 000 (annual)

Required:

a) Assuming the information given above:

i) Calculate the value of the inventory at 31 December 20X1;
ii) Calculate the portion of the fixed manufacturing overheads capitalised to inventory during 20X1;
iii) Calculate the portion of the fixed manufacturing overheads still in the inventory asset account at 31 December 20X1;
iv) Calculate the portion of the fixed manufacturing overheads that have been expensed during 20X1;

v) Show all journals possible. Assume that all transactions/ events were processed as single transactions and that, where applicable, amounts were paid in cash;
vi) Calculate the amount at which cost of inventories expense will be disclosed in the income statement for the year ended 31 December 20X1.

b) Assuming that actual annual production totalled 60 000 units (instead of 30 000 units):

i) Calculate the value of the inventory at 31 December 20X1;
ii) Calculate the portion of the fixed manufacturing overheads capitalised to inventory during 20X1;
iii) Calculate the portion of the fixed manufacturing overheads still in the inventory asset account at 31 December 20X1;
iv) Calculate the portion of the fixed manufacturing overheads that have been expensed during 20X1;
v) Show all journals possible. Assume that all transactions/ events were processed as single transactions and that, where applicable, amounts were paid in cash;
vi) Calculate the amount at which cost of inventories expense will be disclosed in the income statement for the year ended 31 December 20X1.

Ignore tax.

Question 13.6

Buck Limited is a manufacturer of biltong products. The following information relates to its financial year ended on 31 December 20X1.

	C
Balances at 31/12/20X0	
Raw materials	100 000
Work-in-progress	250 000
Finished goods	150 000
Costs incurred during 20X1	
Net cost of raw materials purchased during 20X1	970 000
Marked price of raw materials purchased during 20X1	1 020 000
Less trade discount received	(20 000)
Less cash discount received	(30 000)
Wages (60% manufacturing, 40% administrative): all variable	3 000 000
Variable overheads (60% production; 40% administrative)	1 000 000
Depreciation (80% on manufacturing plant; 20% administrative equipment)	1 000 000
Fixed overheads (70% being factory rent; 30% being managerial staff salaries where these managers are not directly involved in the factory)	1 000 000
Transport costs	
- inwards (i.e. relating to the purchase of raw materials)	100 000
- outwards (i.e. relating to the sale of finished goods)	50 000
Storage warehouse rent and insurance (annual)	100 000
Sales representative salaries (annual)	400 000
Cost of packaging (the biltong is gift wrapped in individual wooden boxes)	
- wooden boxes purchased and used (biltong is gift wrapped in individual wooden boxes)	300 000
- cardboard boxes used for transporting gift-wrapped biltong to sales outlets	500 000

- Buck Limited has an annual expected production level of 250 000 wooden boxes of biltong but produced 200 000 wooden boxes of biltong in 20X1. Fixed overheads are allocated to inventory on units of production. Depreciation on manufacturing plant is considered to be a fixed cost.

- 30% of the cost of raw materials is still on hand at year end.

- 20% of the cost of work-in-progress is on hand at year end, the rest having been completed.

- 10% of the cost of finished goods is still on hand at year end, the rest having been sold.

- No stocks of wooden or cardboard boxes are kept on hand; these are bought as required.

Required:

a) Journalise all information provided above. You may assume that each cost/ transaction was a single transaction and that where relevant, the amount was paid in cash.

b) Soon after 31 December 20X1, the directors decided to cease the production of biltong boxes and produce handbags instead. It has been decided that the **raw materials** on hand at 31 December 20X1 will be sold as is for C300 000. The selling costs thereof are expected to be C50 000. The **work-in-progress** on hand at year end will be completed at an expected cost of C100 000 and will sell for an expected amount of C700 000 (selling costs are expected to be C20 000). The **finished goods** will sell for C1 300 000 and will result in selling costs of C80 000. Calculate the value at which inventories should be measured at year-end and show any journal entries that may be necessary.

c) Disclose all information provided above in the financial statements of Buck Ltd for the year ended 31 December 20X1 in accordance with International Financial Reporting Standards, assuming further that C150 000 of the finished goods have been offered as security for a loan.

Ignore tax.

Question 13.7

A factory with a financial year end of 31st December that started operations on 1 March 20X1 budgeted the following fixed costs:

Supervisor's salary *per annum*	C80 000
Depreciation on equipment *per annum*	C40 000

The supervisor is directly involved in the factory with very little of his time involved in administration duties.

The company allocates fixed overheads based on units produced. The following information relates to the production for the company's first period (10 months) of operation:

Budgeted production for the 10 month period	20 000 units
Budgeted sales for the 10 month period	15 000 units
Actual production for the 10 month period	12 000 units
Actual sales for the 10 month period	10 000 units

Required:

Based on the information given above, calculate:

a) the fixed overhead application rate to be used when valuing inventory at year end;

b) the amount of fixed overheads included in the closing balance of inventory (i.e. on 31 December 20X1); and

c) the total amount of fixed overheads expensed during the period ended 31 December 20X1.

Question 13.8

Widget limited is a manufacturer. Details of their current year inventory is as follows

- Raw materials on hand at the beginning of the year was 10 000 kg at C4 per kg.
- C1 600 000 worth of raw materials at C4 per kg were purchased during the year.
- 100 000 kg of raw materials were used during the year.
- Wages of C500 000 were paid.
- The office telephone account of C20 000 was paid.
- Electricity of C 10 000 was paid. Electricity is charged at C 0.1 per kilowatt. Each unit uses 1 kilowatt. The rest of the bill reflected usage by the administration department.
- A braai costing C8 000 was provided for the factory staff.
- 100 000 units were worked on during the year, of which 90 000 of these were completed during the year with the remaining 10 000 units *effectively* complete at year-end in that no further costs are to be incurred. These 10 000 units still need to undergo the curing process before being moved into the finished goods warehouse.
- Finished goods on hand at the beginning of the year was 20 000 units. The costs per unit in the current year are the same as in the prior year.
- 30% of all available finished goods were sold.
- Fixed rent for factory and administration buildings totalled C400 000, 25% of which is used as office space.
- Budgeted fixed manufacturing overheads are C300 000.
- Budgeted production is 300 000 units (normal production).

All amounts were paid for in cash

Required:

Prepare journal entries to reflect the information presented above.

Question 13.9

Prena Limited manufactures bath oils. The following information is available for January 20X8 (the company's first month of operation):

	C
Raw material purchased (marked price incl. 14% VAT)	605 000
Trade discount received	8%
Settlement discounts offered on purchases of raw materials	4 200
Settlement discounts received on purchases of raw materials	3 200
Variable overheads (30% admin; 70% manufacturing)	100 000
Rent and insurance (see below)	200 000
Salaries and wages (see below)	500 000
Packing materials purchased (see below)	685 000
Other fixed overheads (65% manufacturing; 35% administration)	285 000

Additional information:

- Rent and insurance for the 20X8 year was paid in full on 3 January 20X8. It is comprised as follows:

• Factory	140 000
• Warehouse storage of work-in-progress while oils cools but before the colourings are added	30 000
• Shop where oils are sold to the public	30 000

- Salaries and wages comprise of 55% manufacturing, 15% administration, and 30% sales department salaries. Manufacturing salaries are considered variable with production, while administration and sales department are fixed.

- Packing materials relate to the container in which the oils are placed before sale, and may only be imported from the USA due to its specialized nature. The accountant erroneously converted the dollar amount on the FOB date (free on board) instead of the CIF (costs insurance freight) date. Risks and rewards of ownership were transferred on the date the inventory arrived in the Karachi Port. This was the first (and only) purchase of the packing materials during January. Spot rates were as follows:

Order date		$1: C6
Date goods were loaded in USA harbour	FOB date	$1: C7
Date of arrival in Karachi Port	CIF date	$1: C9

- Other relevant information for January:

  - 75% of packing materials were used
  - 20% of raw materials were on hand at month end
  - There was no work-in-progress at month end
  - 80% of the finished goods produced were sold during the month

- Normal production levels are estimated to be 18 000 units per annum. These 18 000 were expected to be produced evenly over the 12 month period. The actual number of units produced in January was 1 100 units.

- Prema Limited is a VAT vendor. All amounts exclude VAT unless otherwise indicated.

Required:

a) Calculate the carrying amount of each category of inventory at 31 January 20X8 (show all workings clearly).

b) Calculate the value at which the finished goods should be measured on the statement of financial position as at 31 January 20X8, as well as the amount of any write down (if required) assuming that:

- on 31 January 20X8, a flood damaged most of the finished goods on hand;
- expenditure to restore the goods to saleable condition is expected to be C90 000;
- an advertising campaign for the clearance sale will cost approximately C15 000; and
- the oils may then be sold at a discounted price of C400 000.

c) Disclose the inventory note in the notes to the financial statements for the year ended 31 January 20X8 after taking into account the information in (b) above.

Question 13.10

Bilal Limited, an audit client of your firm, has approached you with the following questions regarding inventory:

a) Fabric included in year end inventory includes fabric being shipped from USA on FOB terms (risks and rewards are therefore transferred on date of shipment from the foreign harbour). Delivery costs associated with this special fabric are excessive (C50 000 more than normal delivery costs), but are required urgently for seamless production. Can this C50 000 be included in the inventory value at year end?

b) The company used a consultant to design new baggies (a completely new product with which the company has no experience), at a total cost of C30 000. This was a once-off order for a large surf store chain. The baggies were complete by year end at a total production cost of C500 000. Can the consultant's fees be included in the inventory valuation?

c) During the year, the company produced 85 000 T-Shirts and sold 75 000. Normal production is 100 000 T-Shirts per annum, variable costs are C30 per unit, and annual fixed manufacturing overheads amount to C700 000. Prepare journal entries to record inventory and cost of sales for the year.

d) Fabric X used in production of the T-Shirts, is valued at C40 per metre, but can only be sold at C35 per metre. Finished T-Shirts are expected to sell for C100 and cost C37 to produce. At what value should Fabric X be recognised in the financial statements?

Required:

Respond briefly to all the above queries of your client.

Part 3

Chapter 14
Statement of financial position disclosure: Assets

Question	Key issues
14.1	Accounting policies, property, plant & equipment, investments, inventory, accounts receivable
14.2	Accounting policies, share capital, non-current liabilities, property, plant & equipment, investments
14.3	Journal entries for revaluation of equipment, notes for property plant and equipment, tax and deferred tax
14.4	Current tax and deferred tax, notes: current tax, deferred tax and property, plant and equipment, sale of plant with capital profit
14.5	Revaluation model, revaluation increase followed by revaluation decrease below historic carrying amount with disclosure in the financial statements, includes over and under-provision of tax

Question 14.1

You have been provided with the following final balances, which have been extracted from the general ledger of Misty Ridge Limited, as at 30 April 20X5:

MISTY RIDGE LIMITED
TRIAL BALANCE AT 30 APRIL 20X5

	Debit	Credit
Accounts payable		294 600
Accounts receivable	472 700	
Provision for doubtful debts		9 200
Bank overdraft		18 400
8% Convertible debentures		50 000
Land & buildings	638 000	
Ordinary share capital - shares of C1 each		26 400
Patents and trademarks – carrying amount	45 000	
Plant & machinery - carrying amount	175 000	
Reserves		1 507 800
Inventory	575 700	
	1 906 400	1 906 400

Additional information

- Inventory at year end, which has been valued on a basis consistent with that of the previous year, consists of:

Raw materials	196 400
Work-in-progress	177 300
Finished goods	202 000
	575 700

Inventory is valued at the lower of FIFO cost and net realisable value. The cost of work-in-progress and finished goods include an appropriate portion of manufacturing overheads.

- Accounts payable consist of:

Dividends payable	8 000
Current tax payable	27 520
Trade payables	259 080
	294 600

- The company's land and buildings, which comprise factory and administration buildings, are situated on Plot 101/8, Industrial Area, Karachi. They were purchased on 1 April 19W8 for C580 000. Improvements carried out during April 20X4 totaled C45 000, and are included in the figure of C638 000. The only other improvements to the land and buildings had been undertaken in 20X0.

- The movable assets register, which had not been updated to include the current year's transactions, reflected an accumulated depreciation balance for plant & machinery at 30 April 20X4 of C50 000. Depreciation in the current year amounted to C25 000 for plant and machinery and is provided on the straight-line basis, at 10% p.a.

- The carrying amount of patents and trademarks amortised at 30 April 20X4 amounted to C55 000. The life of the patents and trademarks was considered to be ten years.

- Reserves comprise:

Retained earnings	1 318 800
Capital redemption reserve	189 000
	1 507 800

- Overdraft facilities of the company are secured by a notarial bond on the moveable assets of the company.

- Accounts receivable includes an amount of C5 000 owing by the managing director. The balance outstanding on this loan at the beginning of the year was C15 000. No advances were made during the year.

Required:

Prepare the non-current assets, current assets and current liabilities sections (with relevant notes) of Misty Ridge Limited's statement of financial position at 30 April 20X5, in compliance with International Financial Reporting Standards.

Accounting policy notes should be provided in respect of property, plant & equipment and inventory only.

Question 14.2

Aubergine Limited is a small listed public company, situated on the coastal area. The following information refers to Aubergine Limited at 30 June 20X9.

- The authorised share capital consists of:

  1 000 000 ordinary shares of C1 each
  100 000 6% redeemable preference shares of C1 each

- The company was incorporated ten years ago and shares have been allotted as follows:

856 800	ordinary shares of C1 each.
100 000	6% redeemable preference shares of C1 each at par redeemable at the option of the company at a premium of C0.30 per share at any date after 30 June 20X8.

- After all the adjustments (excepting those relating to the property, plant and equipment) at 30 June 20X9 were made, the balances on the following accounts were:-

Non-distributable reserve	150 000
Retained earnings at 1 July 20X8	290 000
Retained earnings for the current year	78 000

- On 2 January 20X4, 1 000 ten percent debentures of C100 each were allotted. These debentures are redeemable at par in equal annual drawings of C10 000. The first drawing fell due and was paid on 31 December 20X7, and all subsequent drawings have been paid on time. Interest is payable half yearly on 30 June and 31 December of each year.

- The 10% debentures are secured by first mortgage over land and buildings situated on 82-E, Port Qasim. The land and buildings were acquired on 1 June 20X4 for C1 200 000. In 20X6 they were revalued to C1 350 000 and it was decided that land and buildings would be revalued every three years. In June 20X9, Mr Eng of Consulting Engineers CC valued the property at C1 180 000 due to a decline in the property market in the area.

- Plant and machinery at cost less accumulated depreciation at 30 June 20X9 amounts to C90 000. All plant and machinery was acquired on 1 July 20X7 and depreciation is being written off at 20% per annum on the straight line basis.

- Furniture and fittings at cost at 30 June 20X9 amounts to C14 000, and accumulated depreciation at that date amounts to C6 000 (20X8:C5 500). New furniture costing C4 000 was purchased on 30 June 20X9.

- Accounts receivable at 30 June 20X9 amounted to C79 000.

- Inventory is valued at cost using the first in first out method and comprises merchandise only. Total inventory at 30 June 20X9 is C65 000.

- A final dividend of 5% on all issued ordinary shares and the preference dividend was declared but unpaid at year end. These amounts, together with an accrual for taxation of C18 700 were included in accounts payable totalling C101 400.

- There was a bank balance at 30 June 20X9 of C64 200.

Required:

Prepare the statement of financial position and supporting notes of Aubergine Limited at 30 June 20X9 in compliance with International Financial Reporting Standards.

Accounting policies are required for statement of compliance, basis of preparation, property plant and equipment and inventory only.

Comparative figures are not required.

Question 14.3

Adare Limited is a company involved in the manufacturing and distribution of woolen items such as blankets, jerseys and scarfs. The company began operations on 2 January 20X3, renting premises in Rawalpindi.

On 2 January 20X3, the company purchased equipment as well as a large delivery vehicle. Both the equipment and the vehicle were available for use as intended by management from the date of purchase.

The equipment was purchased for an amount of C2 736 000, inclusive of VAT. The estimated useful life is five years with no residual value. The tax authorities allow a tax allowance of 33 1/3 % per annum on the straight line basis. On 1 January 20X4, the equipment was revalued by an independent sworn appraiser to a fair value of C5 000 000, using the net replacement cost method. The estimated useful life remained unchanged. It is the intention of the company to keep the equipment. The company has a policy to transfer the revaluation surplus to retained earnings as the asset is used by the entity.

The vehicle was purchased for an amount of C1 368 000, inclusive of VAT. The vehicle is depreciated at 20% per annum on the straight line basis with no residual value. The tax authorities allow a tax allowance of 33⅓ % per annum on the straight line basis. By the end of the 20X4 year, management realised that the vehicle was too big and it was sold on 31 December 20X4 for an amount of C1 500 000.

The company tax rate was 30% during the year ended 31 December 20X3. However, with effect from 1 January 20X4 the Minister of Finance announced a change in the company tax rate to 29%. The VAT rate is 14%.

The profit before tax for the year ended 31 December 20X4 has been correctly calculated at C2 900 000. Dividend income amounted to C40 000 and was received during January 20X4. Dividends of C52 000 were declared during February 20X4 in respect of the 20X3 year while dividends of C45 000 were declared during February 20X5 in respect of the 20X4 year.

Adare Limited is a registered VAT vendor.

Required:

a) Prepare *all* the journal entries relating to the equipment for the year ended 31 December 20X4.

   Entries relating to taxation and deferred taxation are required.

b) Prepare the notes to taxation and deferred taxation for the 20X4 financial statements. *Comparative figures **are not** required.*

c) Prepare the notes to property, plant and equipment for the 20X4 financial statements.

   *Comparative figures **are** required.*

   Accounting policies are not required.

Question 14.4

Read Limited publishes magazines in the areas of health and fitness. The financial director is in the process of preparing the financial statements for the year ended 31 May 20X6.

The following information is taken from the working papers:

- Profit before tax (including depreciation and profit on sale of plant) for the year ended 31 May 20X6 amounts to C1 720 000.

- All of the company's equipment was purchased on 1 March 20X2 at a cost of C1 000 000 and at that date the residual value was estimated at C200 000. The residual value remained at C200 000 for the 20X2, 20X3 and 20X4 financial years. At the end of the 20X5 financial year the residual value was estimated at C355 000. The company accounts for depreciation on plant on the straight line basis over its useful life of ten years. The allowance granted by the tax authorities is 20% per annum on the straight line basis, apportioned for time. The equipment was sold on 28 February 20X6 for C1 500 000.

  The directors decided to rent equipment (valued at C1 500 000) for a short period so that the latest model could be purchased. New equipment was purchased on 1 May 20X6 at a cost of C1 800 000. Costs of testing the equipment amounted to C200 000 and costs of staff training and preparing the manuals amounted to C10 000. The plant became available for use on 31 May 20X6.

- An extract from the current assets and current liabilities sections of the draft statement of financial position at 31 May 20X6 is as follows:

	20X6	20X5
Current assets		
Accounts receivable	3 750 000	3 240 000
Rent prepaid	30 000	40 000
Interest accrued	25 000	20 000
Current liabilities		
Accounts payable	2 574 000	1 984 000
Subscriptions unearned	10 000	30 000
Advertising accrued	15 000	10 000
Current tax payable	?	8 800

- The following comments have been provided by the company's tax consultant:

  - Prepaid expenses are deductible for tax purposes when paid;
  - Accrued income is taxed in the year of accrual;
  - Unearned income is taxed when received; and
  - Expenses accrued are deductible in the year of accrual.

- Dividends declared and paid during the year ended 31 May 20X6 amount to C50 000. Dividends received during the same period amount to C60 000. The company intends to increase its dividends by 5% each year. The company has also sold the dividend-yielding investments at the end of the financial year. Dividend income is taxed @ 10%.

- The tax assessment for the year ended 31 May 20X5 was received during March 20X6 and showed an assessed tax on taxable profit of C240 000 for the year. The amount owing was paid immediately. The current tax provided in the 20X5 financial statements amounted to C237 250 and provisional tax payments totaled C228 450 for that year. Provisional tax payments amount to C450 000 for the 20X6 year of assessment, excluding the provisional payment made during March.

  There are no other temporary differences other than those evident from the information stated above. The rate of normal company tax is 29%.

Required:

a) Prepare an extract from the statement of comprehensive income of Read Limited for the year ended 31 May 20X6.

b) Prepare all the journal entries relating to taxation for the 20X6 year

c) Prepare the notes to the financial statements for the 20X6 year in respect of taxation, deferred taxation and property, plant and equipment only, in accordance with the relevant IFRS.

   *Comparatives **are not required** for the taxation note.*

   *Comparatives **are required** for the deferred tax note and the property, plant and equipment note.*

   Accounting policies are not required.

Question 14.5

Environmental Limited is a small company listed on the Karachi Stock Exchange. It manufactures a range of energy-saving and environmental friendly household appliances. The year-end of the company is 30 June.

An extract from the trial balances of Environmental Limited at 30 June 20X6 and 20X7 are shown below. All amounts shown on the trial balances are correct.

ENVIRONMENTAL LIMITED
(EXTRACT FROM) TRIAL BALANCE AT 30 JUNE

	20X7		20X6	
	Debit	**Credit**	**Debit**	**Credit**
Retained earnings (at beginning of year)		?		2 300 000
Profit before tax		880 000		1 100 000
Deferred tax	?	?		40 890
Current tax payable		?		4 875
Plant	?		825 000	
Accumulated depreciation : Plant		?		0
Interest received in advance		12 000		15 000
Rent prepaid	8 000		6 000	
Telephone expense accrued		3 850		3 600

The company purchased its only item of plant on 1 July 20X5. It was installed and available for use in the manner intended by management on the same day. The cost of the plant was C900 000. It has an estimated useful life of four years and zero residual value. The Tax authority allows a tax allowance of 25% per annum.

Environmental Limited uses the revaluation model for the measurement of its property, plant and equipment and due to the nature of its operations, the company has a policy of revaluing its property, plant and equipment on an annual basis. The net replacement value method is used. The directors transfer the revaluation surplus to retained earnings as the asset is used by the entity.

The fair value of the plant was estimated using discounted cash flows by an independent valuer at 30 June 20X6 and 30 June 20X7 as shown in the following table. The useful life and residual value remained unchanged.

Date	Fair value
30 June 20X6	R 825 000
30 June 20X7	R 400 000

The tax assessment for the year ended 30 June 20X6 was received on 15 October 20X6 and reflected assessed tax of C326 750. The notes to the financial statements for the year ended 30 June 20X6 reflected a current tax expense of C322 850. The company made a third provisional payment on 20 October 20X6.

Provisional tax payments made during the year were as follows:

Date	Amount
30 December 20X6	R 150 750
30 June 20X7	R 182 250

The corporate tax rate is 29% and has not changed for the past three years.

Required:

a) Prepare extracts from the statement of comprehensive income and statement of changes of equity of Environmental Limited for the year ended 30 June 20X7 and extracts from the statement of financial position at 30 June 20X7, *relating to plant and to taxation.*

b) Prepare extracts from the notes to the financial statements of Environmental Limited at 30 June 20X7, *relating to plant and to taxation.*

The accounting policies for property, plant & equipment and deferred tax are required.

Accounting policies for statement of compliance and basis of preparation are not required.

Comparatives are not required

Part 4

Chapter 15
Share capital

Question	Key issues
15.1	Ordinary shares: rights issue and capitalisation issue: journals
15.2	Statement of changes in equity, share capital disclosure and EPS
15.3	Redemption of preference shares at a premium, issue of debentures, issue of the minimum number of ordinary shares
15.4	Redemption of preference shares at a premium, issue of ordinary shares
15.5	Redemption of preference shares at a premium, issue of ordinary shares: disclosure and journals
15.6	Journal entries, redemption of preference shares at a premium, issue of the minimum number of ordinary shares
15.7	Redemption of preference shares at a premium, issue of ordinary shares
15.8	Redemption of preference shares, restriction on use of share premium
15.9	Classification of redeemable preference shares: discussion, calculations and correcting journals

Question 15.1

The following information relates to Bear Limited's share issues during the year ended 31 December 20X4:

- Rights issue: 10 000 ordinary shares were offered to existing shareholders at C6 each on 30 May 20X4, when the market price was C9 each. All 10 000 shares offered were taken up on this day.

- Capitalisation issue: there was a capitalisation issue of 2 ordinary shares for every 5 shares in issue on 30 November 20X4. The capitalisation issue utilised the share premium as far as is possible. The directors agreed that the impact of the capitalisation issue on the retained earnings should be minimized as far as possible.

Additional information:

- Share issue expenses were C15 000 during 20X4.

- The share premium account had a balance of C30 000 on 31 December 20X3.

- The number of ordinary shares in issue on 1 January 20X4 was 270 000.

- There is a large balance in the retained earnings account.

- There are no other share issues or reserves other than those mentioned above.

Required:

Prepare all the journal entries relating to the transactions mentioned above for the year ended 31 December 20X4.

Question 15.2

Wolverine Limited is a manufacturer and wholesaler of high density metals and metal products. The company is renowned for its production of indestructible metal claws used in industrial processes. The company has been very profitable since its inception fifteen years ago. The company has a 31 March year end. The financial director Logan Wolff has approached you for assistance in preparation of the financial statements.

An extract from the audited statement of financial position as at 31 March 20X1 showed the following balances:

EQUITY AND RESERVES	
	C
Ordinary share capital (C1 each)	1 800 000
12% Non-cumulative preference share capital (C5 each)	500 000
Share premium	150 000
Non-distributable reserve	100 000
Retained earnings	9 500 000
	12 050 000

The total comprehensive income earned for the subsequent two years is as follows:

	20X3	20X2
	C	C
Profit for the period	1 100 000	930 000
Other comprehensive income	50 000	-
Total comprehensive income	1 150 000	930 000

The total comprehensive income for the period has been calculated after taking into account the following items:

Debit / (Credit)	20X3	20X2
	C	C
Depreciation	70 000	60 000
Profit on sale of motor vehicles	-	(20 000)
Amortisation of patents	20 000	15 000
Impairment of goodwill	40 000	40 000
Research costs expensed	23 000	18 500
Emergency repairs to computers	300 000	-
Inventory write-down	-	5 000
Reversal of inventory write down	(3 000)	-
Reversal of impairment loss on plant	(20 000)	-
Effect of change in tax rate	-	(8 200)
Audit fees	80 000	76 000
Entertainment	4 000	4 500
Legal fees – debt collection	200	100
Revaluation of plant and equipment	50 000	-

The following additional information is relevant:

Ordinary share capital

- The ordinary issued share capital at 1 April 20X1 consisted of 1 800 000 shares of C1 each. The authorised share capital has remained unchanged at 5 000 000 since incorporation.
- On 1 July 20X1, 200 000 additional shares were issued at C1.20. The directors' wives took up 50 000 of the shares in total. The share issue expenses for this issue amounted to C10 000.
- On 31 December 20X2, the directors authorised a capitalisation issue of 1 share for every 4 held.
- An ordinary dividend of C0.05 per share was declared on 28 February 20X3. No dividend was declared in the 20X2 financial year.
- In terms of members' resolution 101, the un-issued shares remain under the unrestricted control of the directors until the next annual general meeting.

Preference share capital

- The preference shares are not redeemable.

- All the authorised preference share capital has been issued.
- The preference dividends were paid on 10 October in both years.

Non distributable reserve

- The non-distributable reserve relates to the revaluation of plant and equipment.

Retained earnings and share premium

- The share premium arose on the original issue of the preference shares.
- It is the company's policy to maintain its retained earnings at the highest possible level and to utilise the share premium account to the maximum extent possible.

Tax effects

- The motor vehicle was sold for less than the original cost.
- The impairment of goodwill is not deductable for tax purposes.
- The corporate tax rate is 30%.

***Required*:**

a) Prepare the statement of changes in equity for the year ended 31 March 20X3 in accordance with International Financial Reporting Standards.

b) Prepare the notes to share capital, earnings per share for year ended 31 March 20X3 in accordance with International Financial Reporting Standards.

Comparative figures are required.

Accounting policies are not required.

Question 15.3

Klaus Limited has an authorised share capital of 300 000 ordinary shares of C1 par value and 100 000 redeemable preference shares of C1 each. Its issued share capital consists of 200 000 ordinary shares of C215 000 and 100 000 16% redeemable preference shares issued at par. In terms of the Articles of the company, the preference shares are redeemable at a premium of 3% at the option of the company any time after 1 April 20X3.

The preference shares were redeemed at a premium of 3% on 30 June 20X5. All dividends due had been paid on 29 June 20X5.

In order to finance the redemption, on 30 June 20X5 the company issued 30 000 C1 debentures at a discount of 2% and the minimum number of ordinary shares required at C1.25. Retained earnings amount to C140 000 on 30 June 20X5. The company wishes to minimise the use of its retained earnings account.

The directors are satisfied that the company's assets, fairly valued exceed its liabilities and that the company will be able to pay its debts as they become due.

Required:

Show the relevant extracts from the statement of financial position, statement of changes in equity and notes thereto at 30 June 20X5 in terms of International Financial Reporting Standards and the Companies Ordinance, 1984.

Comparatives are not required.

Question 15.4

The following information was extracted from the records of Century Limited at 29 April 20X9:

	C
Authorised share capital	
300 000 ordinary shares of C2 each	600 000
120 000 15% redeemable preference shares of C0.50 each	60 000
	660 000
Issued share capital	
220 000 ordinary shares of C2 each	440 000
120 000 15% redeemable preference shares of C0.50 each	60 000
	500 000
Retained earnings	120 000
Cash at bank	8 000

The redeemable preference shares are redeemable at the option of Century Limited. The board of directors of Century Limited passed a resolution in terms of which the preference shares are to be redeemed on 30 April 20X9 at a premium of C0.05 per share. The redemption as well as the preference dividend is financed out of:

- the funds in the bank account
- a secured loan of C40 000 at 14%
- the balance from a fresh issue of ordinary shares at an issue price of C2.50

The directors are satisfied that the company's assets, fairly valued exceed its liabilities and that the company will be able to pay its debts as they become due.

The directors have resolved further that

- the share premium account is to be used to the maximum extent possible;
- a balance of at least C70 000 is to remain on the retained earnings; and
- a balance of C3 000 is to remain in the bank account.

Other information relating to the ordinary share issue:

- share issue expenses of C1 200 incurred and paid from existing funds in the bank account are written off against retained earnings;
- there was no balance on the share premium account before the issue of ordinary shares (and no other equity accounts other than those evident from the information provided).

The financial year end is 31 December when the annual preference dividend is declared. The preference dividend will be paid to the date of redemption.

Required:

a) Calculate the number of ordinary shares that the company will issue.

b) Prove that your scheme will fulfil the directors' requirements by showing the retained earnings and cash accounts.

Question 15.5

Yusuf Ltd is a company listed on the JSE Securities Exchange. The financial director is currently preparing the financial statements for the year ended 31 December 20X3. The following information relates to its share capital:

	Number
Ordinary shares of C2 par value, (issued at C2.20 on incorporation – there were no share issue expenses on this issue)	1 000 000
10% C3 preference shares, (issued at par on 1 January 20X1) compulsorily redeemable at a premium of C0.50 per share on 31 December 20X3	1 000 000

The effective interest rate on the preference shares is 14.8084%.

The redemption of the preference shares is to be financed as follows:

- a bank loan of C1 800 000 raised on 31 December 20X3, repayable on 31 December 20 X6; and
- the issue of as many ordinary shares as is necessary at an issue price of C2.50 each (there are 3 million authorised shares still available for issue).

The directors are satisfied that the company's assets, fairly valued exceed its liabilities and that the company will be able to pay its debts as they become due.

Preference dividends are always declared and paid on 31 December of each year. The preference dividends declared on 31 December 20X3 will, together with the share issue costs of C20 000, be paid out of currently available cash resources. No ordinary dividends were declared in 20X3.

On 1 January 20X3, the balance in the retained earnings account was C4 000 000 and the balance in the share premium account was C150 000. The profit for 20X3 was C100 000 before taking into consideration the information presented above.

Required:

a) Prepare the effective interest rate table from the date the preference shares were issued to the date on which they were redeemed.

b) Disclose the preference shares on the face of the statement of financial position as at 31 December *20X2* presenting *20X1* as comparatives in as much detail as is possible. *Notes are not required.*

c) Calculate the number of shares to be issued on 31 December 20X3 in order to finance the redemption of the preference shares.

d) Show all journal entries relating to the information provided above for the year ended 31 December 20X3.

Question 15.6

Emnet (Private) Ltd was incorporated on 1 January 20X5 with an authorised share capital of 310 000 ordinary shares and 50 000 10% redeemable preference shares of C2 each which are subject to compulsory redemption on 31 December 20Y0 at a premium of C0.20 per share.

On 2 January 20X5 all the preference shares were issued at par and 300 000 ordinary shares were issued for C300 000. On 2 January 20X8 an additional 100 000 ordinary shares were issued for C145 000.

Emnet (Private) Ltd's financial year end is 31 December. Preference dividends are paid annually on 31 December.

On 31 December 20Y0 the directors resolved the following with regard to the redemption of the preference shares:

- The preference shares are redeemed at a premium of C0.20 per share as authorised by the articles of association.

- The redemption of the preference shares (together with the preference dividends due for 20Y0) will be partially financed by the issue of the remaining authorised ordinary shares at C2.40 each. The required number of shares were subscribed for and allotted. The balance of the funds needed to finance the redemption will be obtained from the issue of 10% debentures of C10 each. The balance of C20 000 in the bank account is not to be used to finance the redemption.

The directors are satisfied that the company's assets, fairly valued exceed its liabilities and that the company will be able to pay its debts as they become due.

Required:

Prepare the journal entries (including cash transactions) to record the transactions in the accounting records of Emnet (Private) Ltd for the year ended 31 December 20Y0.

Question 15.7

On 28 February 20X5 RFK Limited had, amongst others, the following balances in its accounting records:

	C
Ordinary share capital (shares of C1 each)	400 000
12% redeemable, cumulative preference share capital (shares of C2 each)	157 500
Share premium	480 000
Retained earnings	115 000
Bank overdraft	30 000
Profit before finance charges and before tax	98 000

- The authorised share capital of the company comprises 1 000 000 ordinary shares of C1 each, and 100 000 preference shares of C2 each.

- The preference shares were issued on 1 March 20X0 at par, and are redeemable at the option of the shareholders on 28 February 20X5 at a premium of C0.10.

- The directors have been granted a general authority by the annual general meeting to issue shares at their discretion.

In finalising the financial statements, the following information in relation to the preference shares must still be accounted for:

- The redeemable preference shares are redeemed at C2.10 per share on 28 February 20X5 in accordance with the articles of association. The redemption is financed as follows:

  - 100 debentures of C250 each
  - as many ordinary shares at C1.25 each as are necessary to have sufficient cash for the redemption.

The directors are satisfied that the company's assets, fairly valued exceed its liabilities and that the company will be able to pay its debts as they become due.

- The dividends on preference shares must still be accounted for, and will be financed from the existing bank overdraft.

- Share issue expenses of C9 000 were incurred. These costs are to be financed by extending the bank overdraft.

- The share premium account must be utilised to the maximum extent possible.

- The normal tax rate is 29%.

Required:

Prepare the equity and liabilities section of the statement of financial position at 28 February 20X5 as well as the statement of changes in equity for the year ending on that date.

Accounting policies and notes relevant to the ordinary share capital and preference shares are required.

Comparative figures are required for the statement of financial position.

Question 15.8

Easyfly Limited is a small tour operator. The statement of financial position of Easyfly Limited at 31 August 20X5 is shown below:

EASYFLY LIMITED
STATEMENT OF FINANCIAL POSITION
AT 31 AUGUST 20X5

	C
ASSETS	
Non-current assets	
Property, plant and equipment	125 000
Current assets	
Accounts receivable	24 150
Bank	75 850
	225 000
EQUITY AND LIABILITIES	
Capital and reserves	
Share capital (100 000 C1 Ordinary Shares)	100 000
Share premium	20 000
Retained earnings	51 230
Current liabilities	
10 % Redeemable preference share	53 770
	225 000

The company issued 50 000 10% redeemable preference shares of C1 each on 1 September 20X1 which are subject to compulsory redemption on 31 August 20X6 at a premium of C0.10 per share. The effective interest rate on the preference shares is 11.5870684%.

The terms of the articles of association allow for a premium on redemption of preference shares of C0.10 per share.

The redemption of the preference shares is to be financed as follows:

- C32 500 of the existing cash reserves is to be used
- the remainder is to be financed by the issue of as many ordinary shares as is necessary at a premium of C0.50 per share.

The preference dividend as well as the share issue costs of C2 750 will be settled out of currently available cash resources. No ordinary dividends were declared during 20X6.

The directors are satisfied that the company's assets, fairly valued exceed its liabilities and that the company will be able to pay its debts as they become due.

The share premium account is to be used to the maximum possible amount.

The profit before tax for the period ending 31 August 20X6 has been correctly calculated at C120 000.

The normal tax rate is 29%.

Required:

a) Prepare all journal entries relating to the information provided above for the year ended 31 August 20X6.

b) Show how taxation will be disclosed in the notes to the financial statements for the year ending 31 August 20X6.

Workings to be rounded to the nearest rand.

Comparatives are not required.

Question 15.9

You are the newly appointed auditor of Keeptrying Ltd, charged with the responsibility of ensuring that the equity and liabilities section of the statement of financial position is fairly reflected. The following extract from the draft statement of financial position and additional information relevant to the current financial year ended 31 December 20X4 has been given to you:

KEEPTRYING LIMITED
EXTRACTS FROM STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 20X4

	20X4 C	20X3 C
Issued share capital		
Ordinary share capital: C1 shares	100 000	100 000
Preference share capital: 10% cumulative, redeemable C1 shares	300 000	300 000

The following additional information is relevant:

- 100 000 ordinary shares of C1 each were issued on 1 January 20X1.
- 300 000 redeemable preference shares, each with a coupon rate of 10% and a par value of C1, were issued on 1 January 20X3. These shares are compulsorily redeemable on 31 December 20X5 at a premium of C0.10 per share. The effective interest rate is 12.937%.
- The preference dividends are declared and paid on 31 December each year.

- Journal entries processed to date in respect of the preference shares are as follows:

	Debit	Credit
1 January 20X3		
Bank	300 000	
Preference shares		300 000
Issue of preference shares		
31 December 20X3		
Preference dividend	30 000	
Bank		30 000
Payment of preference dividend		
31 December 20X4		
Preference dividend	30 000	
Bank		30 000
Payment of preference dividend		

The directors are satisfied that the company's assets, fairly valued exceed its liabilities and that the company will be able to pay its debts as they become due.

- All amounts are considered to be material.

Required:

a) Provide the following definitions per the Framework:

   i) Liability

   ii) Equity

   iii) Expense

b) Discuss the recognition of the following transactions:

   i) The ***issue*** of the preference shares in terms of the *liability and equity* definitions.

   ii) The ***redemption*** of the preference shares on 31 December 20X5 in terms of the *expense* definition.

c) Prepare the entire effective interest rate table and state the balance at which the preference shares should be measured in the statement of financial position of Keeptrying Ltd at *31 December 20X4.*

d) Provide the accountant with correcting journal entries where considered appropriate.

Ignore taxation.

Part 4

Chapter 16
Financial instruments

Question	Key issues
16.1	Issue at a premium, redemption at par
16.2	Issue at a discount, redemption at a premium
16.3	Issue at par, redemption at a premium
16.4	Financial risks and mitigation thereof: discussion
16.5	Redeemable debentures: calculations and statement of comprehensive income disclosure
16.6	Redeemable debentures: discussion
16.7	Convertible debentures: journals
16.8	Preference shares: redeemable/ convertible preference shares: journal entries
16.9	Preference shares: compulsorily redeemable preference shares and compulsorily convertible preference shares: discussion and correcting journal entries
16.10	Options, ordinary shares and preference shares: classification, measurement calculations and journal entries
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16.12	Financial assets: classification and journals
16.13	Foreign available for sale financial asset: brief discussion and journals
16.14	Various financial instruments: journals
16.15	Investments in shares and gilts: journals

Question 16.1

Aarhus Limited issued 80 000 12% debentures of C2 each on 1 July 20X3 at a premium of 3%. The debentures have been issued at an effective interest rate of 11.48029%. These debentures will be redeemed at par in 10 years time, on 30 June 20Y3. The debentures are unsecured.

Required:

Show the relevant extracts from the statement of comprehensive income, statement of financial position and notes to the financial statements of Aarhus Limited for the years ended 30 June 20X4, 20X5 and 20Y2.

Question 16.2

Bergen Limited has a 31 December year end. The company issued 100 000 10% debentures of C1 each at a discount of 5% on 1 October 20X1. The debentures are redeemable at a premium of 7% on 30 September 20X5. The debentures have been issued at an effective interest rate of 13.03192248%. Interest is payable on 31 March and 30 September each year.

Required:

a) Prepare all the journal entries relating to the debentures that would be processed from 1 October 20X1 to 30 September 20X5.

b) Show how the debentures would be disclosed in the financial statements of Bergen Limited at 31 December 20X2.

Question 16.3

Elk Limited issued C100 000 debentures on 1 January 20X1 at par. Interest at the rate of 12 % p.a. is payable on 31 December each year. The debentures are to be redeemed at a premium of 26.262% on 31 December 20X6. The premium was calculated so that the effective cost of the debentures after providing for the premium on redemption, would be 15% p.a.

The amount that will be required for the premium on the redemption of the debentures is to be provided for over the life of the debentures using the effective rate of interest method.

The debentures are secured over the land and buildings of the company.

The company's financial year end is 31 December.

Required:

a) Prepare an amortisation table showing the amount of premium that would be provided each year over the life of the debentures.

b) Prepare all the journal entries relating to the debentures from the 20X1 financial year to the end of 20X3.

c) Show how matters relating to the debentures would be disclosed in the financial statements and notes of Elk Limited for the 20X3 financial year end.

Question 16.4

Blues Limited, a South African company whose currency is Rands (R), manufactures specialized musical instruments. Since Blues Limited was incorporated in the current year it was unable to raise a loan from a large banking house and was forced to finance the purchase of factory machinery through:

- The issue of debentures to the value of R500 000 (at a 10% fixed rate); and
- A loan of R1 000 000 (at a variable rate of prime plus 15%) from Shark Limited a small lending house.

Both the factory machinery and the raw materials used in the manufacture of the musical instruments are supplied by Country Limited, an American company.

The musical instruments manufactured are sold in both Durban (South Africa) and London (Great Britain), although the majority of the customers are Londoners. Blues Limited offers all its customers 60 days credit.

An extract of Blues Limited's Trial Balance as at 31 December 20X5 is as follows:

	Debit	Credit
Foreign creditor: Country Limited (US Dollars: 125 000)		900 000
Foreign debtors: various (GB Pounds: 30 000)	300 000	
Inventory	600 000	
Debentures		500 000
Loan: Shark Limited		1 000 000
Sales: local		50 000
Sales: foreign		700 000

Required:

a) List the financial risks listed in IFRS 7 to which an entity can be exposed.

b) Discuss the various financial risks to which Blues is currently exposed. Your answer should include the definition of each risk discussed.

c) Discuss how Blues may limit their exposure to these risks.

Question 16.5

On 2 January 20X5, Tinkerbell Limited issued 1 million C5 10% debentures at a discount of C1 per debenture. The debentures are compulsorily redeemable, on 31 December 20X9, at a premium of C1.23 per debenture. The internal rate of return is 19.992737%.

Required:

Determine the amount to be recognized as finance costs for each of the affected financial years ending 31 December and show how these amounts would be disclosed in the statement of comprehensive incomes of Tinkerbell Limited.

Question 16.6

Backstab Limited issued 200 000 C20 par value debentures on 1 January 20X6. These debentures:

- were issued at a discount of 20% on par; and
- are redeemable at a premium of C3 over par value on 1 January 20X9;
- bear interest at 12% per annum, payable annually in arrears. The internal rate of return is 26.33586%.

Backstab Limited's accountant processed the following journal entries in respect of these debentures for the financial year ending 31 December 20X6.

	Debit	Credit
1 January 20X6		
Bank	3 200 000	
Non-current interest bearing liability		3 200 000
Issue of debentures		
31 December 20X6		
Finance costs – debenture interest	480 000	
Interest payable		480 000
Accrual of interest on debentures		

The tax authorities apply the effective interest rate method to financial liabilities and levy normal income tax at 30%.

Required:

Evaluate Backstab Limited's accounting treatment of the compulsorily redeemable debentures for the year ended 31 December 20X6.

Question 16.7

Sharks Limited is a company that is involved in the retail of sporting goods. Due to the massive increase in demand for the merchandise sold by Sharks Limited, they believed it was necessary to build a massive sporting goods mall. This mall only sells sports-related goods.

In order to raise the required capital, Sharks Limited issued 100 000 C10 debentures on 1 January 20X6. The details of the debentures are as follows:

- The debentures were issued at a premium of C1 per debenture
- The coupon rate is 15%
- The debentures are compulsorily convertible into ordinary shares on a 1 for 1 basis on 31 December 20X9.

An appropriate discount rate for debentures of this nature is 20%.

Required:

Journalize the entries required to account for the above information for the years ended 31 December 20X6 to 20X9.

Question 16.8

Paw Paw Limited issued 1 000 000 C5 10% cumulative preference shares at par on 1 January 20X5. These shares are, at the option of the holder, either convertible into ordinary shares or redeemable at par on 31 December 20X8:

- On 31 December 20X8, 80% of the shareholders decided to convert their preference shares into ordinary shares and 20% of the shareholders opted for the cash back instead.
- The market interest rate for these preference shares is 12%.

Required:

Prepare the journal entries for the share issue in the books of Paw Paw Limited for the years ended 31 December 20X5 to 20X8, including the conversion.

Question 16.9

Blunder Limited's accountant quit in November 20X5 just before the year ended. They have employed a new, but inexperienced accountant, who is unsure how to treat the following share issues:

- Blunder Limited issued 500 000 10% compulsory redeemable preference shares. They were issued at par (C4) and are redeemable at par on the 31 December 20X8. The market interest rate is 10% for similar preference shares.
- On 1 January 20X5 Blunder Limited issued 400 000 C2 (12%) compulsory convertible preference shares at par. They are convertible on the 31 December 20X9 into ordinary shares. The market interest rate for similar shares is 15%.

The accountant has processed the following journals:

	Debit	Credit
Bank	2 000 000	
Preference shares: Equity		2 000 000
Issue of redeemable preference shares		

	Debit	Credit
Bank	800 000	
Preference shares: Equity		800 000
Issue of convertible preference shares		

Required:

Discuss whether or not the above journals are correct and if not provide the *correcting* journal entries.

Question 16.10

Happiness Limited purchased the following on 1 January 20X5:

- 100 options to buy Smiley Limited shares on 25 November 20X6 for C200 each. The options were trading at C300 each at 31 December 20X5. Happiness Limited on the purchase of these options designated them to be *fair value through profit or loss.*
- 200 Grin Limited shares for C150. These were classed as *available for sale.* The fair value of these shares was C200 at 31 December 20X5.
- 300 compulsory redeemable preference shares (10%) in Giggle Limited. They cost C10 and are redeemable on 31 December 20X8 at C14. Happiness Limited *did not designate* these as *fair value through profit or loss.* The effective interest rate of these preference shares was calculated to be 17.70%.

Required:

Calculate the carrying amount of each of the above financial instruments and provide all the necessary journal entries for the year ended 31 December 20X5.

Question 16.11

Sneedon Limited issued 10 000 C2 @ 10% cumulative preference shares on the 1 January 20X6 at a 10% discount off the face value. The shares are convertible, at the option of the shareholders, into ordinary shares at a rate of 10 preference shares for 1 ordinary share.

Should the preference shareholders not elect to convert their shares into ordinary shares, the preference shares will be redeemed at a premium of C1 per share on the 31 December 20X9.

Sneedon Limited classified the C18 000 preference shares as equity and presented preference dividends of C2 000 in the statement of changes in equity. Share issue expenses of C1 000 were incurred by Sneedon Limited and were reflected as an expense in the statement of comprehensive income.

Required:

Critically analyze the acceptability of the above accounting treatments for the year ended 31 December 20X6 and provide the correct treatment if necessary.

Question 16.12

On the 1 January 20X6 Mich Limited issued 1 000 000 C10 par value fixed rate 10% compulsory redeemable preference shares at par value. The preference shares are compulsory redeemable at C15 each on the 31 December 20X10. Preference dividends are paid annually in arrears on the 31 December.

The ex-dividend market value of the preference shares was as follows:

Date	Market price (C)
31 December 20X6	11
31 December 20X7	12
31 December 20X8	9
31 December 20X9	14
31 December 20X10	15

The effective interest rate is 17.11239%.

Kim Limited purchased all 1 000 000 preference shares on 1 January 20X6.

Required:

a) Discuss the possible methods that Kim Limited could apply in accounting for its financial asset (i.e. its investment in Mich Limited's preference shares).

b) Given the above ex-dividend market values of Mich Limited's preference shares, prepare the journal entries in Kim Limited's general journal assuming that Kim Limited considers its investment to be:

   i) designated as fair value through profit or loss;

   ii) held to maturity;

   iii) available for sale.

c) Assuming that Kim Limited earned other profit in each year (i.e. before considering any income related to the financial instruments) of C1 000 and assuming that Kim Limited designated the investment in the Mich Limited preference shares as available for sale, prepare the:

   - statement of comprehensive income; and
   - statement of changes in equity.

   Ignore tax.

d) Repeat part (c) assuming that the tax rate is 30%.

Question 16.13

On 1 January 20X9, Marshall Ltd bought a €10 000 debenture at a discount of 5%. It has a coupon rate of 7% p.a. and matures in 10 years at face value. It was designated as available for sale.

Interest is payable annually in arrears and the effective interest rate is 7.736% p.a.

On 31 December 20X9 (year end), the fair value of the debenture was €10 500.
Exchange rates on various dates were as follows:

Date	**€1: C**
1/1/X9	12.10
31/12/X9	11.70
Average X9	11.90

Required:

a) Briefly describe the correct accounting treatment of the debenture in respect of interest, exchange differences, and fair value adjustments.

b) Prepare all necessary journals for 20X9. Ignore tax.

Narrations are not required.

Question 16.14

Bering Ltd entered into the following transactions during the year ended 31 December 20X9:

a) On 1 March 20X9, the company purchased debentures at a discount of 2% off the face value of C100 000. A coupon rate of 11% p.a. is payable biannually in arrears on 30 August and 28 February every year. The debentures will be redeemed in 5 years at a premium of 5%. The entity has the intent and ability to hold the debentures to maturity. (Effective interest rate = 12.3% p.a.)

b) On 30 June 20X9, the company purchased 100 shares in Midway Ltd at C23 per share, with the intention of long term investment. Transaction costs of C800 were incurred. By year end, the shares were trading at C25 per share. They were not designated at fair value through profit/loss.

c) Also on 30 June 20x9, the company issued 10% redeemable preference shares worth C500 000, redeemable at the option of Bering Ltd. However, if the company's share price falls lower than C14, the preference shares become redeemable immediately. Bering Ltd's share price has never fallen below C16 since incorporation. A final preference dividend of C25 000 was declared on 31 December 20X9.

d) Bering Ltd bought 10 mining share index futures on 1 November 20X9 with speculative intentions. The futures allow the company to buy the shares at an index level of 2500 on 28 February 20Y0. Profits/losses are directly transferred to the company's bank account. A C40 000 margin deposit was made. The index level was 2500 on 1 November 20X9, and had increased to 2700 by year end. (Note: Futures are traded in multiples of 10).

e) On 1 December 20X9, the company bought ten SAFEX call options with a short term intention to sell. This allows the company to purchase the index at 9 000 points on 31 December 20X9. The margin deposit paid was C15 000 and the option was exercised on maturity. The index level was 9 100 on exercise date

Required:

Prepare all necessary journal entries to record the above transactions in the books of Bering Ltd for the 31 December 20X9 financial year. Ignore tax. Narrations are not required.

Question 16.15

Bounty Ltd (year end 31 December) has entered into the following transactions:

- On 1 April 20X8, the company bought 300 shares in a local unlisted company for C6 000. Transaction costs of C600 were incurred. Bounty Ltd had no plans to sell the asset in the immediate future and thus classified the investment as available for sale.

  On 31 December 20X8 the fair value of the investment was C5 900. Exactly a year later, the company sold half (150 shares) at fair value (C18 per share).

- On 1 January 20X9, the company purchased government gilts (face value = C300 000) for C270 000. Coupon interest is levied at 8% p.a., payable biannually. The gilts are redeemable at face value in 3 years. The effective interest rate is 6.034% per 6 months or 12.07% p.a. The company had the positive intent and ability to hold to maturity.

  On 30 June 20X9, the company sold 60% of the gilts at fair value of C170 000. A market related interest rate on the date of sale was 10.6% p.a.

Required:

a) Prepare journal entries for the purchase and subsequent sale of the shares for the 20X8 and 20X9 financial years.

b) Prepare journal entries to record the government gilts in the accounting records for the year ended 31 December 20X9.

Narrations are not required.

Part 4

Chapter 17
Provisions and contingencies

Question	Key issues
17.1	Pollution of environment, provision for rehabilitation costs
17.2	Guarantee for a loan
17.3	Accounting treatment of maintenance costs
17.4	Onerous contract
17.5	Provision for guarantees
17.6	Accounting treatment for the cost of repairing a tanker leaking oil and of cleaning up the environment
17.7	Accounting treatment of a provision for audit fees
17.8	The recognition and measurement of a provision for restructuring
17.9	Provision for future major inspection
17.10	Provision for decommissioning costs, conceptual justification, journal entries, disclosure
17.11	Provision for decommissioning costs: Part A: journals and disclosure Part B: journals and disclosure involving a change in estimate
17.12	Decommissioning costs
17.13	Provision for disposal of medical waste and legal claims

Question 17.1

Toxins Waste Disposal Limited is a company that handles the collection and disposal of toxic waste. The company's financial year ends on 31 December.

On 28 December 20X8 one of the company's tankers transporting a load of toxic waste turned over during a storm and spilled its load. The waste seeped into the ground on the side of the road polluting the area for several hundred meters. There was a public outcry by the local residents and concerned environmentalists that the contamination would spread to a nearby river, which was the source of the resident's water supply.

Due to immense negative publicity, Toxins Waste Disposal Limited's directors published a statement in the newspaper on 30 December 20X8 that the company would remove the contaminated soil and replace it with new soil by 15 February 20X9. On 31 December 20X8 the directors wish to create a provision for the rehabilitation costs but are unable to estimate what the rehabilitation of the contaminated area will cost. This is the first time that this particular chemical has been spilt and a detailed investigation will need to be carried out to determine the extent of the damage that has occurred. The investigation is to be carried out during early February 20X9. The publication date of the financial statements is 31 January 20X9.

Required:

Discuss how the directors of Toxins Waste Disposal Limited should account for and disclose the above situation in the financial statements for the year ended 31 December 20X8 in accordance with The Framework and IAS 37.

Question 17.2

Beta Limited has signed a guarantee for a loan owed by one of the directors of the company, to Standard Bank amounting to C250 000. The managing director, Mr. Beta is unsure of how to treat this guarantee. The company will only be liable for the loan if the director fails to make the payments as they fall due.

Required:

Discuss, in terms of International Financial Reporting Standards, how the guarantee of the director's loan should be treated and disclosed in the financial statements of Beta Limited.

Question 17.3

The accountant of Zimbali Limited is aware that roughly C1 000 000 will be paid in the 20X2 financial year in respect of maintenance costs. This expected expenditure is in accordance with the company policy of performing maintenance on the factory plant once every three years. The accountant wishes to provide for one third of this expected cost in the current year ended 31 December 20X0.

Required:

Critically analyse the above issue, explaining whether the treatment is correct or incorrect and justifying your advice with references to International Financial Reporting Standards.

Question 17.4

Unsure Limited entered into a contract to supply bricks to a new, foreign customer on 1 February 20X8. The order is for the supply of 10 million bricks per month from 1 June 20X8 to 31 March 20X9, a total of 100 million bricks. A special order was placed for these bricks as they are not standard bricks, but are to be used in the construction of a garden cottage for the Princess of Lalaland.

On 1 February 20X8, Unsure Ltd estimated that the contract would cost C10 million. Penalties for late delivery amount to C500 000 and penalties to cancel the contract amount to C2 000 000, payable immediately on late delivery or cancellation. Contract revenue is C1 500 000 per month.

Between February and June 20X8, prices of supplies increased by more than expected, and the cost of producing the first batch was C800 000. Prices continued to rise, and by 31 December 20X8, C12 000 000 had already been spent on the contract, and it was budgeted that C8 000 000 would need to be spent to complete it. Unsure Ltd is considering cancelling the contract, although they do not know how they will find C2 000 000 to pay the penalty for cancelling.

Required:

Discuss how this matter should be recognized and measured in the financial statements of Unsure Ltd for the year ended 31 December 20X8.

Question 17.5

Rich Kid Ltd sells various cheap, but expensive-looking electronic items. All goods are sold with a six-month guarantee, provided by Rich Kid Ltd. Rich Kid Ltd's suppliers are Money-Cruncher Ltd and Super-Duper Ltd. Super-Duper Ltd also offers a 6-month guarantee on all goods sold to Rich Kid Ltd, thus any returns by customers to Rich Kid Ltd will be passed on to Super-duper Ltd for fulfillment. Money-Cruncher offers no such refund policy, although it has occasionally refunded customers for returned goods.

Details of sales of the three companies for the year ended 31 December 20X8 follow. All sales are incurred evenly over the year.

Rich Kid Ltd: C500 000
Money-Cruncher Ltd: C5 000 000
Super-Duper Ltd: C7 000 000

Estimates of returns to the three companies

	Most likely	Worst ever	Best ever
Rich Kid Ltd	15%	30%	10%
Money-Cruncher Ltd	5%	15%	1%
Super-Duper Ltd	10%	18%	8%

Super-Duper Ltd thinks that sales in the last half of 20X8 were lower than usual, and that returns by customers will be low.

Required:

Discuss the recognition and measurement of the above transactions in the accounting records of each company at 31 December 20X8.

Question 17.6

BatterSea Shipping Limited is a South African shipping company that transports crude oil from Saudi Arabia to South Africa. On 28 September 20X9 one of the company's oil tankers was damaged in a violent storm off St Lucia on the KwaZulu Natal coastline (South Africa) and started leaking oil.

Management contracted a specialist repair contractor to repair the damage temporarily at sea, in order to prevent the oil from leaking further. The necessary repairs were carried out on 29 September 20X9 at a cost of C365 000, which was invoiced immediately.

The tanker was then sailed to Durban harbour, South Africa, where the cost of repairing it was assessed to be C2 750 000. Management entered into a contract on 12 October 20X9 to repair the ship at the harbour dry dock. The cost of the repairs would be financed by a loan from the bank at prime +1%.

The oil spill affected a 15 kilometre stretch of coastline and by 29 September 20X9 there had been a huge outcry from the general public, as well as environmentalists who were concerned about the damage to an area of such environmental significance. In light of this, the managing director made a public announcement on 30 September 20X9, on television and in the newspapers, of the company's intention to clean up the entire area affected by the spill.

Clean up of the environment would only commence once an expert team of environmentalists had assessed the extent of the damage and the most effective method of removing the spilt oil. On 20 October 20X9 management engaged a team to perform this assessment. The assessment will be available before 31 October 20X9.

The company's financial year end is 30 September and the financial statements are scheduled to be approved on 15 November 20X9.

Required:

Discuss how the directors of BatterSea Shipping Limited should account for and disclose:

a) the repairs at sea

b) the repairs at the dry dock, and

c) the cost of cleaning up the environment

in the financial statements for the year ended 30 September 20X9 in accordance with the Framework and IAS 37. A discussion of an expense is not required.

Question 17.7

You are the partner in charge of the audit of Granchester Limited., a company listed on the Johannesburg Securities Exchange. The financial year-end of the company is 30 September 20X1 and the directors wish to approve the financial statements for issue on 15 November 20X1.

In finalising the financial statements, the directors wish to create an accrual for audit fees of C1 200 000, of which C900 000 relates to audit work completed at 30 September 20X1 and the C300 000 relates to work done between 1 October 20X1 and 31 October 20X1. All the fees relate to the financial year ended 30 September 20X1.

Required:

Discuss, giving reasons, whether or not you agree with the directors' treatment of the provision for audit fees.

Question 17.8

Yolande Limited is a company that manufactures vehicles for export to Dubai. All parts used in the manufacture thereof are currently manufactured by Yolande Limited. It has recently been discovered, however, that the tyres currently manufactured by a branch of Yolande Limited (situated in Eshowe), cost far more than imported tyres from Ho Sin Limited (situated in Japan). The financial year-end of Yolande Limited is 30 June.

As a result, management has devised a detailed formal plan to close down the Eshowe tyre manufacturing branch of Yolande Limited and thereafter to import tyres instead. This plan was agreed to by every director before 30 June 20X3 and is to be implemented in December 20X4. There are approximately 50 factory and administrative staff at the Eshowe branch who will either be retrenched or retrained and relocated. All costs related to the discontinuance of this branch, having been thoroughly investigated by the company's financial team, are expected to be as follows:

- Annual gains expected from the cost savings in purchasing tyres from Ho Sin Limited in Japan rather than the more expensive tyres from the Eshowe branch: C400 000
- Retrenchment packages: C1 500 000;
- Cost of retraining those employees who will remain employed by and relocated within Yolande Ltd: C500 000.

The directors of Yolande Limited are concerned that, since the closing down of the Eshowe branch is to only take place in December 20X4, staff members who might hear about the plan may resign well before this time. For this reason, the directors have agreed not to announce the plan until 30 September 20X4.

The amounts are material but the plan above has not caused a 'going concern' problem.

Required:

a) State:
   - the definition of a liability; and
   - the recognition criteria

   as provided in The Framework.

b) State:
   - the recognition criteria specific to a provision for restructuring costs, and
   - the definition of 'restructuring',

   as set out in IAS 37

c) Discuss, with reference to the abovementioned definitions and recognition criteria, whether a provision for restructuring costs should be *recognised* in the financial statements at 30 June 20X3.

d) Assuming that a provision for restructuring costs is to be recognised, calculate the *amount* of the provision to be raised in Yolande Ltd's balance sheet as at 30 June 20X3. Briefly justify your answer.

Question 17.9

Flybynight Limited is a delivery company that delivers packages between Durban and Johannesburg on an overnight basis. During the past few years, the trucks have suffered a number of mechanical failures and an increasing number of accidents. In order to reduce the cost of travelling by road, the company purchased an aeroplane at a cost of C4 500 000. As a condition to its continued use, the aeroplane requires a major inspection every 10 000 flying hours. The aeroplane had flown 4 000 hours since its last major inspection on the date of purchase and has flown 273 hours since the date of purchase.

Flybynight Limited has estimated that the next major inspection is expected to cost C500 000 (based on the aeroplane's previous major inspection, which cost the seller C420 000).

The following entry has been processed:

	Debit	Credit
Major inspection (Asset)	500 000	
Provision for major inspection (Liability)		500 000

Required:

Analyze and discuss the accounting treatment of the major inspection. Your analysis should include a discussion of a liability, a provision and an asset.

Question 17.10

Leo Limited leases an industrial site close to a game reserve. The company recently obtained approval for heavy plant and machinery to operate on the site for a period of five years. The approval is in terms of a licence granted by the government. The Minister of Environmental Affairs approved the licence because the main activity of Leo Limited is the production of environmental friendly paper from recycled material.

The plant and machinery was purchased on 1 October 20X2 for C1 000 000. Installation costs of C175 480 were incurred and paid over the months of October, November and December of 20X2. The plant and machinery was in a condition necessary for it to be capable of operating in the manner intended by management on 1 January 20X3.

The plant and machinery has an estimated useful life of five years with no residual value. In terms of the licence, Leo Limited is obliged to dismantle the plant and machinery and restore the area at the end of its useful life. Future decommissioning costs are expected to be C120 000. The company uses a discount rate of 10% to calculate the present value of the decommissioning costs.

The financial accountant prepared the following schedule reflecting the unwinding of the discounted decommissioning costs:

Date	Years to decommissioning date	10% discount factor	PV
01/01/X3	5	0.621	74 520
31/12/X3	4	0.683	81 960
31/12/X4	3	0.751	90 120
31/12/X5	2	0.826	99 120
31/12/X6	1	0.909	109 080
31/12/X7	0	1.000	120 000

Required:

a) Discuss the appropriate accounting treatment for the future decommissioning costs. Your answer should refer to the accounting framework and to the relevant accounting standards.

b) Prepare all the journal entries relating to the above transactions that would have been processed in the accounting records of Leo Limited for the year ended 31 December ***20X3***.

c) Prepare the relevant extracts from the income statement of Leo Limited for the year ended 31 December 20X4 and from the balance sheet at 31 December 20X4. Notes to the financial statements (including accounting policies) are required in respect of provisions only.

Comparatives are required.

Question 17.11

Menace Limited purchased a nuclear plant, the details of which are as follows:

Cash purchase price (1 January 20X1):	C2 000 000
Depreciation straight-line to nil residual values:	10 years

The nuclear plant must be dismantled after 10 years, details of which are as follows:

Future decommissioning cost assessed on 1 January 20X1:	C3 000 000
Discount rate:	10%

Required:

a) Given the information provided above:

i) Show all journal entries for the years from 20X1 to 20X10.

ii) Disclose the 'provision for future decommissioning costs' note in Menace Limited's financial statements for all years affected in accordance with International Financial Reporting Standards.

b) Assuming that during 20X4 it was established that the expected cost of decommissioning has increased to C3 800 000:

i) Show the journal entries from 20X1 to 20X10 inclusive.

ii) Disclose the 'provision for future decommissioning costs' note in accordance with International Financial Reporting Standards for years 20X1 to 20X10 inclusive.

iii) Disclose the separately disclosable items: finance charges and depreciation as well as the change in estimate note in Menace Limited's financial statements, for years 20X1 to 20X4 inclusive, in accordance with International Financial Reporting Standards.

Question 17.12

Transkei Trading purchased a paper mill for C1 000 000. Future expected decommissioning costs of C1 800 000, discounted using a discount rate of 10% to the present value of C694 800, are recognised on the same date.

On 31 December 20X1, the value in use was C800 000 and the expected selling price was C1 200 000 (both figures exclude the decommissioning liability). Depreciation is to be provided on the straight-line method over the expected useful life of the paper mill of 10 years. The current financial year end is 31 December 20X1.

Required:

a) Assuming that the paper mill is purchased on 31 December 20X1:

i) Journalise the acquisition of the asset.

ii) Show the calculation of the impairment loss assuming that Transkei Trading will pay the decommissioning costs.

iii) Show the calculation of the impairment loss assuming that the hope is that a future buyer will pay the decommissioning costs.

b) Assuming that the paper mill is purchased on 1 January 20X1:

i) Journalise the acquisition of the asset, the depreciation of the asset, the unwinding of the discount and the impairment loss, if any.

ii) Show the calculation of the impairment loss assuming that Transkei Trading will pay the decommissioning costs.

iii) Show the calculation of the impairment loss assuming that the hope is that a future buyer will pay the decommissioning costs.

Question 17.13

Parklands Hospitals Limited is a private hospital group operating five hospitals in Karachi. The following information relates to the year ended 31 December 20X6.

Medical waste:

- In terms of environmental legislation the company is required to dispose of all medical waste generated by the hospitals in a socially responsible manner, within two weeks of

generation, failing which penalties may be levied. The company has the necessary permit to dispose of medical waste by incineration on the site of their hospital in Karachi.

- In terms of their permit the company is allowed to dispose of 120 tons of medical waste per annum from 1 January to 31 December. The hospitals generate an average of 10 tons of medical waste per month evenly. On 25 November 20X6 the furnace used to incinerate medical waste malfunctioned and could not be repaired. A replacement furnace was commissioned immediately but will only be completed and installed on 31 January 20X7 at a cost of R1 500 000. A deposit of R500 000 was paid on 15 December 20X6.

- Due to the malfunction of the furnace the company has 12 tons of un-disposed medical waste on hand at 31 December 20X6. Management has obtained a quote from Waste Incinerators to dispose of the waste on hand during January 20X7 at an estimated cost of R10 000 per ton.

- On 25 January 20X7 the company received notification from the Environmental Agency that a penalty amounting to R125 000 would be levied as a result of not disposing of waste within the prescribed period at 31 December 20X6. Management has decided not to raise an objection to this penalty.

Legal claim:

- On 15 October 20X6, a visitor, Mr Downe, the Chief Executive Officer of a large company, slipped on a wet floor in the hospital foyer while on his way to visit his ill mother. As a result of his fall he sustained multiple fractures to his left leg and right arm and was immobilized for 4 months. On 1 December 20X6 Mr Downe filed a lawsuit against the hospital for negligence, claiming damages for the injuries sustained and loss of income suffered as a result of his fall.

- At the 31 December 20X6 the company's attorneys have reported that it is highly probable that Mr Downe's claim will be successful against the company. However they are uncertain how much would be awarded in damages as past rulings of this nature have been inconsistent. The directors have applied their minds to the amount of damages likely to be awarded and have decided that there is not enough information at the present to make a reasonable estimate. The attorneys will gain a better understanding of the possible amount of damages after the first court proceedings to be held on 1 March 20X7.

The following information is relevant:

- The financial statements were approved for issue on 15 February 20X7.

- Profit for the period has been correctly calculated as R2 858 500 (20X5: R2 212 000) after taking the above information into account.

***Required*:**

a) Discuss how the cost of the un-disposed medical waste on hand at 31 December 20X6 *and* the penalty should be *recognised* and *measured* in the financial statements of Parklands Hospitals Limited for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

b) Discuss how the legal claim should be *recognised*, *measured* and *disclosed* in the financial statements of Parklands Hospitals Limited for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

Part 4

Chapter 18
Events after the reporting period

Question	Key issues
18.1	Alleged litigation before reporting date
18.2	Liquidation of a customer
18.3	Inventory write down, liquidation of a customer, date of authorisation
18.4	Understanding the effect of specific events: identification, discussion and journal entries
18.5	Reporting of a guarantee in the financial statements
18.6	Change in market value of investments
18.7	Insolvency of a customer, legal action against entity, obsolete inventory,
18.8	Litigation: provisions, contingencies and post reporting period events

Question 18.1

Bigmouth Limited, a manufacturer of toothpaste, was taken to court over alleged defamation charges when Bigmouth Limited accused a rival toothpaste manufacturer of industrial espionage. Before the year end of 31 December 20X3, the lawyers of Bigmouth Limited advised that, although losing the case was unlikely, legal fees and settlement costs could amount to C800 000 in the event that the court case was lost.

On 4 February 20X4, the judge presiding over the case ruled that Bigmouth should pay C900 000 to the plaintiff as well as pay all of the plaintiff's legal fees, which amounted to C150 000.

The financial statements had not yet been authorised for issue at the time of the court ruling.

Required:

Discuss how this information should be treated in the financial statements of Bigmouth Limited for the year ended 31 December 20X3.

Question 18.2

Penguin Foods Limited received a letter from Total Liquidators on 15 January 20X1, stating that Salmon Fish Shop had been placed into liquidation owing to trading difficulties and that all creditors could expect to receive a liquidation dividend of no more than C0.15 in C1. Salmon Fish Shop owed Penguin Foods Limited C136 000 at 31 December 20X0.

The financial statements for the year ended 31 December 20X0 were approved on 15 March 20X1.

Required:

a) Identify, giving reasons, what type of event this information would be classified as in terms of IAS 10.

b) Disclose all the effects of the above information in the annual financial statements of Penguin Foods Limited as at 31 December 20X0 in accordance with IAS 10.

Question 18.3

Melrose Limited is a company that manufactures and distributes computerised electronic products. The head office is situated at The Melrose Arch with retail outlets and warehouses in different parts of the country. The financial year end of the company is 30 June.

The management of the company completed the draft financial statements for the *year ending 30 June 20X5* on 31 August 20X5. On 18 September 20X5, the board of directors reviewed the financial statements and authorised them for issue. A profit announcement appeared in the press on 19 September 20X5. The financial statements are made available to shareholders on 1 October 20X5 and are approved by shareholders at the annual meeting on 5 November 20X5.

The following events occurred after the end of the reporting period:

a) A major competitor announced a reduction in the price of its MP3 players during July 20X5. The competitor was able to do this because of its ongoing investment in new

technology. Management of Melrose Limited had included the inventory of MP3 players on the draft statement of financial position at its cost of C6 500 000. It is estimated that the net realisable value of this inventory at 30 June 20X5 is C5 000 000 because of the competitor's price reduction.

b) One of Melrose Limited's warehouses is situated on the Kwa-Zulu Natal north coast. A tropical storm struck the area during late August 20X5 and flooded the warehouse, destroying the entire inventory on the ground floor, comprising modems and lightning protector kits. This inventory was included on the draft statement of financial position at 30 June 20X5 at a cost of C3 000 000.

c) A customer of Melrose Limited was placed into liquidation at the end of July 20X5. The amount of C400 000 owing by this customer was included in accounts receivable on the draft statement of financial position at 30 June 20X5.

d) Another customer of Melrose Limited, whose retail outlet was situated on the Kwa-Zulu Natal north coast, announced early in September 20X5 that it was closing down after its premises and all the fixtures and fittings as well as its inventory were destroyed as a result of the August tropical storm. The company was under-insured and was forced to close down. Management of Melrose Limited estimates that it is unlikely that more than C0.30 in the C1 will be paid on liquidation. An amount of C150 000 owing from this customer was included in accounts receivable on the draft statement of financial position at 30 June 20X5.

e) Melrose Limited proposed a bonus scheme for all employees amounting to C200 000. This scheme was approved by the board of directors and communicated to the employees on 19 September 20X5.

Required:

Discuss, with reasons, the nature of each event described above in terms of IAS 10 as well as the appropriate accounting treatment (include any necessary journal entries) and / or disclosure in the financial statements of Melrose Limited for the year ended 30 June 20X5.

Question 18.4

Toddy Limited's financial statements for the year ended 31 December 20X3 have not yet been authorised for issue. The directors are expecting to authorise the release of these financial statements on 5 May 20X4. The following issues, which have not yet been considered, require your attention:

- Vandalism during December 20X3 resulted in the complete destruction of a neighbouring company's warehouse, leading to that company filing for insolvency in January 20X4. This neighbouring company was, unfortunately, one of Toddy Limited's debtors, owing Toddy Limited C100 000 at 31 December 20X3. The liquidators announced in January 20X4 that C0.20 per C1 would be paid upon liquidation. The full balance owing by this debtor is included in the statement of financial position as at 31 December 20X3.

- Toddy Limited owns 100 000 shares in a listed company. At 31 December 20X3 the market price of each of these shares was C5. During March 20X4, war broke out and resulted in the share price dropping dramatically to C2 per share. The investment in shares as at 31 December 20X3 has not been adjusted for the drop in share price.

- Toddy Limited will be issuing 500 000 C1 par value shares on 10 May 20X4.

All amounts are material but none of the issues mentioned above have caused there to be a 'going concern' problem.

Required:

With reference to the treatment of *each* of the three issues in the financial statements of Toddy Limited for the year ended 31 December 20X3:

i) Briefly explain the reasoning for your answer to part (i) above.

ii) Provide the required adjusting journal entries, where appropriate, or state whether or not any related information would need to be disclosed in the abovementioned financial statements.

Set your answer out under the following headings:

a) Insolvent debtor

b) Drop in value of investment in shares

c) Issue of shares

Ignore taxation.

Question 18.5

Simpson Limited is a family owned company that sells designer shorts and skateboards. The year end of the company is 30 June. Draft financial statements *for the year ended 30 June 20X3* were prepared *at 30 June 20X3* based on information available at that date. The directors are currently in the process of reviewing all available information prior to publishing the financial statements *on 30 September 20X3.*

At the beginning of August 20X2, Simpson Limited signed a guarantee amounting to C1 000 000 for the borrowings of a major supplier, Smithers Limited, whose financial condition at that time was sound. At 30 June 20X3, the directors of Simpson Limited still believed the financial condition of Smithers Limited to be sound. However, it has since come to light that the financial condition of Smithers Limited has been deteriorating since early 20X3 and at 30 August 20X3 it filed for protection from its creditors.

Required:

a) Discuss, with reasons, how the guarantee would have been reported in the *draft* financial statements of Simpson Limited for the year ended 30 June 20X3.

b) Discuss, with reasons, how the guarantee should be reported in the *published* financial statements of Simpson Limited for the year ended 30 June 20X3.

Question 18.6

Core Limited is a small company that designs customised software solutions for clients. The year end of the company is 30 June. Draft financial statements *for the year ended 30 June 20X3* were prepared *at 30 June 20X3* based on information available at that date. The directors are currently in the process of reviewing all available information prior to publishing the financial statements *on 30 September 20X3.*

Core Limited has a portfolio of investments where it invests excess cash on the stock exchange. At 30 June 20X3, the cost of the investments was C650 000 and the market value amounted to C725 000. During August 20X3, however, market conditions worsened and the market value dropped to C625 000 when the published financial statements were being finalised for publication.

Required:

Discuss, with reasons, how this matter should be reported in the published financial statements of Core Limited for the year ended 30 June 20X3.

Question 18.7

Blossom Limited is a large distributer of fresh flowers. The company has large contracts to supply florists and corporate event co-ordinators throughout the country. The financial director and his staff are in the process of preparing the financial statements for the year ended 31 December 20X8.

The following events took place between the reporting period date and the date of authorisation of issue of the financial statements:

a) It was discovered that a customer, Violet Florists, who owed C100 000 at year-end was declared insolvent on 15 January 20X9 after its premises burnt down over the previous weekend. The premises were completely destroyed and were not insured.

b) Legal action was brought against Blossom Limited for delivering old flowers to an event co-ordinator who needed them for a government function that hosted foreign heads of state on 23 December 20X8. The claim is for C10 000. Blosssom Limited's lawyers believe it is highly likely that Blossom Ltd will have to pay C10 000.

c) Flowers in stock often pass their sell-by date before they are sold and are left in the corner of the store room. At the year-end stock count on 31 December, some old flowers were inadvertently included in stock at their cost of C5 000. They will never be sold by Blossom Limited.

d) There was a burglary at Blossom Limited's premises on 2 January 20X9 and pesticide and insecticide to the value of C10 000 was stolen. Such items are included in consumable stores.

The financial statements are authorised for issue on 20 January 20X9.

Required:

Prepare the journal entries that are necessary to correct the financial statements of Blossom Limited to ensure compliance with International Financial Reporting Standards. Provide reasons as to why a journal entry is / is not prepared.

Question 18.8

Lemon Limited is a company that produces jam and tinned fruit. It has a 31 December year end.

Lemon Limited purchased 200 tons of long-life limes on 2 December 20X2 for C500 000, half of which had been used in the production of marmalade by year-end. All the marmalade produced from this delivery of long-life limes had been sold to Pack-a-Sack Limited

(a popular nation-wide grocery chain) by year-end. On 10 December 20X2, a customer of Pack-a-Sack Limited suffered serious food poisoning and alleged that it was caused by a bottle of marmalade purchased from Pack-a-Sack Limited. This customer proceeded to take Lemon Limited to court over the poisoning. Lemon Limited is not insured against the potential losses that may result from the court case.

Due to public interest on a national level, the case went to court almost immediately. Indications during the court proceedings held in late December 20X2 were that Lemon Limited was probably responsible for the poisoning and would probably be found guilty: it was found that the marmalade was poisoned because the long-life limes used in its manufacture were transported by the supplier together with a load of insecticide, which had contaminated the limes. It was impossible, however, to reliably estimate the settlement costs at year-end. Due to the negative publicity arising from the court case, Lemon Limited has decided not to plead against the inevitable 'guilty' verdict and to willingly pay all costs, in the interests of salvaging a positive public image.

The following additional information is relevant:

- **Estimated costs:** During January 20X3, Lemon Limited's lawyers estimated that the court would award the plaintiff C2 500 000 whereas an out-of-court settlement would probably be C2 200 000.

- **Findings of the specialists:** Specialists hired by Lemon Limited in January 20X3 confirmed that 20% of the balance of the long-life limes in stock at year-end are also contaminated and must be destroyed.

- **Warnings by lawyers:** Lemon Limited has been unable to keep the case out of the media and their lawyers warned in December 20X2 that as soon as the verdict was published in the media, more, similar cases will probably be brought against Lemon Limited by other aggrieved customers, although it was impossible to estimate the number of cases or their financial impact.

- **Returns:** Pack-a-Sack Limited had sold all of the bottles of marmalade by 31 December 20X2. By the time the financial statements were authorized for issue on 15 February 20X3, no bottles of marmalade had been returned. It seems that there is only a remote chance that there would be any returns at this late stage.

All amounts are material but none of the issues mentioned above have caused there to be a 'going concern' problem.

Required:

Discuss, with reference to IAS 10, how – if at all – the events should be recognised and measured in the financial statements of Lemon Limited for the year ended 31 December 20X2 in order to comply with International Financial Reporting Standards.

You should use the following headings in your discussion:

- Estimated costs
- Findings by specialists
- The warning
- Possible returns

Part 4

Chapter 19
Leases

Question	Key issues
Section A	**Leases in general and Lessees**
19.1	Lease classification: theory
19.2	Lease classification: theory comparing the Framework to IAS 17
19.3	Lessee: Operating lease: journals
19.4	Lease classification: theory and journals
19.5	Lessee: Operating lease: journals and disclosure
19.6	Lessee: Operating leases with subleasing, VAT and normal tax: disclosure
19.7	Lessee: Finance lease: journals and disclosure
19.8	Lessee: Finance lease and normal tax: journals and disclosure: A: ignoring VAT B: with VAT
19.9	Lessee: Sale and operating leaseback: journals a) SP greater than market related and rentals greater than market-related b) SP less than market related but rentals not less than market related
19.10	Lessee: Sale and operating leaseback: journals a) SP greater than market related and rentals greater than market-related b) SP greater than market related and rentals equal to market-related c) SP less than market related and rentals less than market related d) SP less than market related but rentals not less than market related
19.11	Lessee: Sale and finance leaseback: a) SP and rentals are market related b) SP and rentals are below market related
19.12	Lessee: Sale and finance leaseback: journals and disclosure
Section B	**Lessors**
19.13	Lessor: Operating lease: journals
19.14	Lessor: Finance lease: journals and statement of financial position disclosure
19.15	Lessor: Finance lease: journals (instalments in advance)
19.16	Lessor: Finance lease: journals (instalments in arrears with initial costs)
Section C	**Lessors and lessees**
19.17	Multiple leases: disclosure (involves VAT and shows the deferred tax effect)

Question 19.1

As part of a major expansion plan, North Limited entered into an agreement to lease a building from South Limited. The agreement is as follows:

• Lease term	8 years
• Inception date	1/1/20X0
• Payment	
o Years 1 to 5	C5 000 per month
o Years 6 to 8	C2 000 per month
• Market value at inception	C1 000 000
• Useful life	20 years

Required:

Justify how North Limited should classify the above lease agreement in terms of IAS 17.

Question 19.2

Citizen Limited entered into an agreement with Bigbrother Limited on 1 January 20X7, the terms of which are as follows:

- Citizen Limited will lease equipment from Bigbrother Limited;
- The lease will be for 3 years;
- The lease may not be cancelled;
- There will be 3 lease instalments of C500 000 each, payable annually in advance (starting on 1 January 20X7);
- The equipment will be returned to Bigbrother Limited at the end of the lease.

At the time of the signing of the agreement, the useful life of the equipment was estimated to be 10 years, at which point it is estimated that it will be worthless.

The cash cost of this equipment is C5 000 000.

Required:

a) Discuss how Citizen Limited should account for the lease in its financial statements for the year ended 31 December 20X7, using the asset and liability definitions in the Framework as your guide.

b) Discuss how Citizen Limited should account for the lease in its financial statements for the year ended 31 December 20X7, using IAS 17 as your guide.

Question 19.3

The company at which you are employed as a financial manager entered into the following operating lease agreement (as lessor) to lease an item of PPE:

- Lease term is 3 years commencing 1 January 20X6

- Lease payments:

31 December 20X6	54 720
31 December 20X7	67 260
31 December 20X8	29 640

- Initial direct costs of lessor were C3 000 paid in cash.

Your company is a registered VAT vendor and has correctly classified the agreement as an operating lease.

Required:

a) Calculate the rental income that will be recorded for each year.

b) Journalise all entries which involve the initial direct costs for the 20X7 financial year ending 31 December.

Question 19.4

Hello Limited leased office furniture from Goodbye Limited. According to the lease agreement, ownership transfers from Goodbye Limited to Hello Limited at the end of the lease term. The cash cost of the furniture is C497 370. The payment schedule is as follows:

			Liability	
Date	**Interest (10%)**	**Instalment**	**Capital repaid**	**Balance**
1/1/20X2				497 370
31/12/20X2	49 737	(200 000)	150 263	347 107
31/12/20X3	34 711	(200 000)	165 289	181 818
31/12/20X4	18 182	(200 000)	181 818	-
	102 630	(600 000)	497 370	

Hello Limited depreciates office furniture over its estimated useful life of 3 years, using the straight-line method, to a nil residual value.

Required:

a) Justify how Hello Limited should classify the above lease agreement.

b) Show the related journal entries for the year ended 31 December 20X2.

Ignore tax and journal narrations.

Question 19.5

Moon Limited is a lorry manufacturer. On 1 January 20X3, Moon Limited entered into an operating lease (as a lessee) over a computer system. Details of the annual lease rentals, payable in arrears, are as follows:

• 20X3	0
• 20X4 to 20X6	C30 000 per annum
• 20X7	0
• 20X8 to 20X10	C10 000 per annum

Moon Limited's profit before tax is C900 000 in 20X3 (after correctly accounting for the lease).

The tax authorities grant a 20% capital allowance on owned assets but allow a deduction from taxable profits of the lease payments if the asset is leased. The normal tax rate is 30%. There are no other temporary differences other than those evident from the information provided. Moon Limited satisfies the requirements to raise deferred tax assets.

There are no components of other comprehensive income.

Required:

a) Prepare the 20X3 journal entries with regard to the above lease agreement.

b) Draft the following to fully disclose the above lease and its tax effect:

- Statement of comprehensive income for the year ended 31 December 20X3
- Statement of financial position as at 31 December 20X3
- Notes to the financial statement for the year ended 31 December 20X3

Note that the accounting policy note is required, whilst the deferred tax note is not required.

Question 19.6

On 2 July 20X4, Dux Limited entered into a 2-year operating lease (as lessee) over an item of plant, which it then leased (under a 2-year operating lease) to Thick Limited (a sub-lessee). The relevant details, from the perspective of Dux Limited, are as follows:

- Lease rentals paid by Dux Limited

30 June 20X5:	C50 000
30 June 20X6:	C40 000

- Lease rentals received by Dux Limited

30 June 20X5:	C20 000
30 June 20X6:	C30 000

The tax authorities grant a 20% capital allowance on owned assets but allow a deduction from taxable profits of the lease payments if the asset is leased. The tax rate is 30%.

Required:

Prepare the 'profit before tax' note for inclusion in Dux Limited's financial statements for the year-ended 30 June 20X5 in conformity with International Financial Reporting Standards.

Question 19.7

Tweet Limited is an airplane manufacturer, listed on the JSE Securities Exchange.

On 1 January 20X3, Tweet Limited entered into a finance lease (as a lessee) over a motor vehicle with a cash cost of C700 000. Details of the lease agreement are as follows:

- Payments of C200 754 are made annually in advance;

- The lease term is 4 years; and
- The interest rate implicit in the lease is 10%.

Tweet Limited depreciates the motor vehicle over 4 years, on the straight-line method, to a nil residual value. Tweet Limited's profit before tax is C900 000 in 20X3 (correctly calculated).

The tax authorities:

- grant a 20% capital allowance on owned assets but
- allow a deduction from taxable profits of the lease payments if the asset is leased.

The normal tax rate is 30%.

There are no other temporary differences other than those evident from the information provided. Tweet Limited satisfies the requirements to raise deferred tax assets.

There are no components of other comprehensive income.

Required:

a) Prepare the 20X3 journal entries with regard to the above lease agreement.

b) Draft the following to fully disclose the above lease and its tax effects:

- Statement of comprehensive income for the year ended 31 December 20X3
- Statement of financial position as at 31 December 20X3
- Notes to the financial statement for the year ended 31 December 20X3

Note that the accounting policy note is required, whilst the deferred tax note is not required. Ignore VAT.

Question 19.8

On 2 April 20X2, Quack Limited entered into a lease agreement (as a lessee) over a delivery van with a cash cost of C124 343. Details of the lease agreement are as follows:

- The lease is for a three-year period;
- Lease rentals of C50 000 are payable annually in arrears;
- The first lease rental is due to be paid on 31 March 20X3;
- The interest rate implicit is 10%; and
- At the end of the three-year period, ownership of the van passes to Quack Limited.

Quack Limited has correctly classified this lease as a finance lease and depreciates the vehicle over 3 years to a nil residual value using the straight-line method.

Quack Limited's profit before tax for the year ended 31 March 20X3 is C300 000 (after correctly accounting for the lease).

The tax authorities:

- grant a 20% capital allowance on owned assets but
- allow a deduction from taxable profits of the lease payments if the asset is leased.

There are no components of other comprehensive income.

The tax rate is 30%, and Quack Limited meets the criteria to raise deferred tax assets.

Required:

i) Show the journals relating to this lease for the year ended 31 March 20X3. Tax journals are not required.

ii) Disclose the following extracts of Quack Limited's financial statements in conformity with International Financial Reporting Standards:

- the statement of comprehensive income for the year ended 31 March 20X3
- the statement of financial position as at 31 March 20X3
- the notes to the financial statement for the year ended 31March 20X3, specifically:
  - Finance costs;
  - Taxation expense;
  - Property, plant and equipment; and
  - Interest-bearing non-current liabilities.

Ignore tax unless otherwise indicated.

Question 19.9

On 3 January 20X3, Star Limited entered into a sale and operating leaseback for a machine that had a carrying amount of C800 000 (original cost is C1 200 000).

The market prices in respect of a sale and leaseback arrangement are:

- Fair selling price C1 800 000
- Fair annual rental C200 000
- Lease term 4 years

Required:

Prepare the journal entries in the accounting records of Star Limited to account for the sale and operating leaseback for the year-ended 31 December 20X3, assuming that the lease agreement stipulates:

a) a selling price of C2 000 000 and annual rentals of C300 000.

b) a selling price of C1 500 000 and annual rentals of C200 000.

Ignore all taxes.

Question 19.10

Baby Limited entered into a sale and operating leaseback arrangement with Mummy Limited over Baby Limited's plant. Baby Limited had originally purchased the plant for C500 000 on 1 January 20X4 and had depreciated it by C100 000 by 2 January 20X5, the date on which the sale and operating leaseback agreement was signed.

Fair market prices in respect of this sale and leaseback are as follows:

- Fair selling price C750 000
- Fair annual rental C150 000

Required:

Prepare the journal entries necessary to record the sale and leaseback in Baby Limited's accounting records for the year ended 31 December 20X5 assuming the lease agreement stipulated a:

a) selling price of C1 000 000 and an annual rental of C200 000 payable annually in arrears for four years;

b) selling price of C1 000 000 and an annual rental of C150 000 payable annually in arrears for four years;

c) selling price of C500 000 and an annual rental of C75 000 payable annually in arrears for four years;

d) selling price of C500 000 and an annual rental of C150 000 payable annually in arrears for four years.

Ignore all taxes.

Question 19.11

Hundreds Limited entered, as a lessee, into a four-year sale and finance leaseback with Millions Limited. The affected asset is a vehicle that had originally cost Hundreds Limited C200 000.

By 2 January 20X5, the date on which the lease agreement was signed, Hundreds Limited had already depreciated this vehicle to a carrying amount of C100 000 but estimated the remaining useful life of the vehicle to be four years with a nil residual value.

Fair market prices in respect of this sale and leaseback are as follows:

- Fair selling price C500 000
- Fair annual rental C75 000

The interest rate implicit in the lease agreement is 10%.

Required:

Prepare the journal entries to record the sale and leaseback of the vehicle in the accounting records of Hundreds Limited for the year ended 31 December 20X5 assuming the lease agreement stipulated a:

a) selling price of C500 000 and an annual rental of C75 000 payable in arrears for four years plus a compulsory repurchase at the end of the period of C383 975;

b) selling price of C400 000 and an annual rental of C50 000 payable in arrears for four years plus a compulsory repurchase at the end of the period of C353 590.

Ignore all taxes.

Question 19.12

On 3 January 20X3, Woof Limited entered into a sale and finance leaseback (as lessee) over one of its buildings for a four-year period. On this date, the building had

- a carrying amount of C1 000 000 (original cost is C1 250 000);
- a tax base C1 000 000; and
- a remaining useful life of 4 years.

The building was sold for C1 200 000, and annual payments of C378 565 are required at the end of each year. The interest rate implicit in the lease agreement is 10%.

Woof Limited's profit before tax is C900 000 in 20X3 (correctly calculated).

The tax authorities:

- grant a 20% capital allowance on owned assets but
- allow a deduction from taxable profits of the lease payments if the asset is leased.

The normal tax rate is 30%.

There are no other temporary differences other than those evident from the information provided. Woof Limited satisfies the requirements to raise deferred tax assets.

There are no components of other comprehensive income

Required:

a) Prepare the 20X3 journal entries with regard to the above lease agreement.

b) Disclose the above lease and its tax effect in the statement of comprehensive income for the year ended 31 December 20X3, in the statement of financial position on this date, an in the related notes, in accordance with International Financial Reporting Standards.

Note that the accounting policy note is required, whilst the deferred tax note is not required. Ignore VAT.

Question 19.13

Sleepless Limited purchased a factory on 1 January 20X5 for C1 500 000. This factory was initially to be used as the premises from which Sleepless Limited would manufacture beds and then wholesale them to retail stores.

However, as soon as they had acquired the building, Sleepless Limited entered into a contract to supply the Royal Inn with new beds. The Royal Inn was replacing all their existing beds in anticipation of the large number of visitors that would be staying at their establishment due to the soccer world cup. This meant that the factory purchased did not have adequate space to store the number of beds required to supply this customer.

As a result Sleepless Limited rented out the premises to a tenant with immediate effect. The details of the lease agreement are as follows:

Start of lease	1 January 20X5
End of lease	31 December 20X9
Annual lease instalment	C100 000 (increased annually by 20%)
Lease payment	annually in arrears on the 31st of December each year

Sleepless Limited holds all investment property under the cost model and believes that the total useful life of this building is 10 years and that it has a nil residual value. These estimates remained unchanged.

Required:

Journalise the entries required in the books of Sleepless Limited to account for the information above for the years ended 31 December 20X5, 20X6, 20X7, 20X8 and 20X9.

Ignore all taxes.

Question 19.14

Applebee Limited is a manufacturer of harvesting equipment. Applebee Limited sells the equipment to farmers all around the country. Some customers purchase the equipment for cash and others purchase under Applebee Limited's finance lease arrangement.

Mr. Hatfield purchased a harvester from Applebee Limited and made use of their finance lease agreement. The details of the lease are as follows:

- The lease period is 5 years (signed on 1 January 20X5)
- Lease instalments of C200 000 are payable annually in arrears on 31 December.

A fair market interest rate for this type of lease is 16.9911%.
The cost to Applebee Limited to manufacture this harvester was C500 000. Applebee Limited implements a mark-up of cost plus 28% on their cash sales.

Required:

a) Journalise the entries required to account for the abovementioned transaction for each of the years ended 31 December 20X5 to 20X9 in the books of Applebee Limited.

b) Disclose the statement of financial position and finance lease debtor in the books of Applebee Limited for the year ended 31 December 20X9.

Ignore all taxes.

Question 19.15

Midnite Corporation is a company involved in the entertainment industry. It recently decided to import a range of new lighting equipment costing C400 000. Once the equipment had arrived at their premises (1 January 20X6), it became evident that Midnite Corporation did not have the expertise necessary to operate the sophisticated equipment.

The CEO then made a few calls and found a company (DAT Entertainment) that wanted to acquire the equipment. Unfortunately, however, DAT Entertainment did not have adequate funds to purchase the equipment immediately. The CEO was reluctant to leave the equipment lying around, and therefore came up with the following agreement:

- He would lease the equipment to DAT Entertainment, immediately (1 January 20X6).

- The equipment would be leased to DAT Entertainment for a period of 3 years.

- At the end of 3 years DAT Entertainment would have to pay an amount of C20 000 and ownership would then transfer.
- The lease rentals are C150 000 paid annually in advance.

Other information includes:

- A fair market interest rate for agreements of the above nature is 17.082%.
- The tax authority taxes lease instalments when received.
- The normal tax rate is 30%. There is no transaction tax (i.e. no VAT).
- The useful life of the equipment is estimated to be 3 years and this is the same period over which the tax authority allows the equipment to be written off for tax purposes.

Required:

Provide the journal entries required to account for the above information in the records of Midnite Corporation.

Question 19.16

Automatic Ltd (a dealer and manufacturer) sold a vehicle to Betamatic Ltd under a finance lease agreement. The fair value of the vehicle is C246 760 on transaction date.

The markup (to normal cash selling price) is 30% on cost.

The details of the lease agreement are as follows:

- Lease term is 5 years commencing 1 January 20X5
- Annual arrear payments beginning on 31 December 20X5 are C70 000
- A guaranteed residual value is due on 31 December 20X9 of C50 000
- The market interest rate is 17%
- The lessor incurred initial direct costs of C2000 cash.

Automatic Ltd follows IAS 17 and has correctly classified the lease as a finance lease.

Automatic Ltd has a 31 December year-end.

The profit before tax (correctly calculated for the lease agreement) is C600 000 (it contains no temporary or permanent differences other than those evident from the above transaction).

Required

Prepare the journal entries for the 20X5 financial year in the records of Automatic Ltd.

Ignore normal tax.

Question 19.17

Faith Limited entered into four lease agreements during the 20X7 financial year. Details regarding these leases are given below.

Factory Building:

- Faith Limited leased a factory building to Olga Limited on the 1/1/X7. The lease is classified as an operating lease.

- The lease agreement provides for the following lease instalments (excluding VAT), receivable annually in arrears:

20X7	100 000
20X8	200 000
20X9	300 000
20X10	200 000

  Contingent rentals of 1% of Olga Limited's operating profit are also required. Olga Limited generated operating profit of C5 000 000 in 20X7.

- This building was originally purchased on 1/1/X2 for C10 000 000 (excluding VAT).

Vehicle:

- Faith Limited leased a vehicle from Stantheman Limited on the 1/1/X7. The lease is classified as a finance lease.

- The rate implicit in the lease agreement is 10%.

- There are five lease instalments due of C527 595 each (including VAT). These are payable annually in arrears.

- The fair value of the vehicle was C2 000 000 (including VAT) at inception of the lease.

- Initial direct costs of C57 000 (including VAT) were incurred by Faith Limited

Plant:

- Faith Limited, being a manufacturer of plant, leased an item of plant to Regan Limited (where Faith Limited is the lessor), effective from the 1/1/X7. The lease is classified as a finance lease.

- Three lease instalments of C329 003 (including VAT) are required annually in advance.

- The rate implicit in the lease agreement is 10%.

- The asset originally cost C1 000 000 on the 1/1/X5 (excluding VAT).

- The selling price stated in the agreement was C900 000 (including VAT).

- Initial direct costs of C114 000 (including VAT) were incurred by Faith Limited. These costs are allowed as a deduction by the tax authorities in the year incurred.

Land:

- Faith Limited leased land from Mali Limited from the 1/1/X7. This lease is classified as an operating lease.
- Payments of C1 000 000 are required annually (excluding VAT) for a period of 10 years

Additional information:

- The tax rate is 30%.
- All parties mentioned are VAT vendors. The VAT rate is 14%.
- Faith Limited policy on depreciation is to depreciate all assets on straight line to nil residual at the following rates:

Factory Building	10%
Vehicles	25%
Plant	20%

The tax authorities provide a tax depreciation allowance on assets calculated on cost at the following rates:

Factory Building	5%
Vehicles	33 1/3%
Plant	25%

- Faith Limited's profit before tax (correctly calculated) was R5 000 000 in 20X7.
- There are no components of other comprehensive income.

Required

Prepare, in accordance with International Financial Reporting Standards, Faith Limited's:

- statement of financial position;
- statement of comprehensive income; and
- notes to the financial statements.

for the financial year ended 31 December 20X7.

Accounting policies are not required.

Comparatives are not required.

Part 4

Chapter 20
Statement of financial position disclosure: Equity and liabilities

Question	Key issues
20.1	Understanding the raising of funds by the issue of debentures or preference shares
20.2	Redemption of preference shares, debentures
20.3	Redemption of preference shares in installments, debentures
20.4	Redeemable preference shares, debentures

Question 20.1

Stylish Limited has been operating successfully in the clothing retail business for a number of years and has stores all over Pakistan. Its directors believe that in order to control inventory more efficiently and to promote the company's modern image, it would be beneficial to install at all stores computerised bar code scans which would automatically update stock records. The company would need to obtain C500 000 from external sources in order to undertake this venture.

The directors do not wish to issue shares that have voting rights. They are considering the issue of either debentures or redeemable preference shares as a means of raising the necessary finance but are unsure as to which to select.

The company has generated satisfactory profits over the past three years and its gearing ratio (total debt : total assets) is currently 30%, with debt amounting to C1.2 million. The company has however experienced some cash flow difficulties in the past due to the large amounts needed to finance working capital. The industry demands a fair amount of inventory selection and generous credit terms (six months), which are not reciprocated by suppliers. It is expected that the improved inventory control resulting from the computerisation will alleviate these problems to some extent. The directors are optimistic about the company's future but would prefer not to be committed to a specific date for the repayment of borrowings.

Required:

Discuss in point form the factors which need to be considered by the directors of Stylish Limited in deciding whether to raise the required funds by issuing debentures or preference shares.

Question 20.2

Williamson Limited issued 15 000 C1 10% redeemable preference shares on 1 March 20X1. The shares are subject to compulsory redemption by the company on 28 February 20X4. On 28 February 20X4 the directors resolved to redeem the preference shares at a premium of C0.05 per share. This was in accordance with the terms of the original issue.

In order to obtain funds for the redemption, the company issued 20 000 unsecured, C1 12% debentures on 1 February 20X4 at a discount of 3%, to be redeemed on 31 January 20X9 at a premium of 2%. These debentures were issued at an effective interest rate of 13.1640%.

The directors wish to utilise the share premium account to the maximum extent possible. The balance on the retained earnings account was C120 000 at 28 February 20X4, before any entries had been processed relating to the effect of the above transactions on the debentures, preference shares and dividends.

Required:

Prepare an extract from the statement of financial position and notes to the financial statements of Williamson Limited for the year ended 28 February 20X4, in terms of the requirements of the Companies Ordinance, 1984 and International Financial Reporting Standards.

Calculations must be made to the nearest whole number.

Question 20.3

The following balances were extracted from the trial balance of Nourish Limited at 27 February 20X7 (before the redemption of the preference shares):

	Debit	Credit
Ordinary share capital (C1 shares)		100 000
Share premium		25 000
Retained earnings at 27/02/20X7		78 000
12% Preference share capital (C1 shares)		30 000
Premium accrued – preference shares		498
12% Debentures (C1 par value)		15 000
Discount on issue – debentures	150	
Premium accrued – debentures		0
Bank	25 000	

- The following information relates to preference shares:
  - The preference shares, which were issued at par on 1 March 20W7 are subject to compulsory redemption by the company in three equal annual installments starting on 28 February 20X5. The remaining 30 000 preference shares are due for redemption on 28 February 20X7 at a premium of 2%, which was provided for at the date of issue in the articles of association.
  - The accounting entry to record the payment of the preference dividend as well as the related effective interest and premium accrued for the year ended 28 February 20X8 has not yet been processed.
  - The minutes of the most recent directors' meeting reflect the decision to use C15 000 from the bank account to pay all amounts owing to the preference shareholders and to raise the balance needed through an issue of ordinary shares at a premium of C0.20 per share.
  - Entries in respect of the redemption of preference shares and the new shares issued have not yet been passed.
  - The distributable reserves are to be minimally impacted in accounting for the above.
  - The debentures were issued on 1 June 20X6 at a discount of 1% and are redeemable at a premium of 1.5%, in equal annual installments over 3 years. The first repayment is due on 31 May 20X8. Interest is payable annually in arrears on 31 May. The debentures were issued at an effective interest rate of 12.87537%. Entries for the current year in respect of the amortisation of the discount or premium have not yet been passed and interest has not been accrued.

Required:

Disclose the above information in the statement of financial position of Nourish Limited for the year ended 28 February 20X7.

Notes are not required. Round off to the nearest whole number.

Question 20.4

Scott Limited is a company listed on the stock exchange. The company exports swimming pool equipment and chemicals.

SCOTT LIMITED
EXTRACT FROM TRIAL BALANCE AS AT 30 JUNE 20Y0

	Debit	Credit
Ordinary share capital		500 000
15% Redeemable preference share capital		200 000
Retained earnings - 30/6/X9		335 500
14% Debentures - 30/6/X9		200 000
Debenture discount - 30/6/X9	4 947	
Share issue expenses	1 688	
Net profit before interest and taxation		265 750
Taxation	70 227	
Bank	160 250	
Dividends paid - ordinary	12 500	
- preference	15 000	
Loan - Investments Bank		120 000
Shareholders application account		168 750
Payments to preference shareholders	235 000	
Interest paid on debentures	14 000	
Interest paid on loan - Investments Bank	13 000	

The following information is relevant:

- The authorised share capital of the company consists of:

  500 000 ordinary shares with a par value of C2 per share.
  500 000 redeemable preference shares with a par value of C0.50 per share.

- On 1 September 20X9 the share premium was fully utilised to make a capitalisation issue of 1 share for every 9 shares to ordinary shareholders. On 30 June 20X9 225 000 ordinary shares were in issue.

- The redeemable preference shares were issued at par on 1 January 20X4. These preference shares are redeemable at a premium of C0.05 per share at the option of the company any time after 31 December 20X8. Management has classified these shares as equity for reporting purposes. The premium on redemption was provided for in the Articles of Association at the date of issue. The directors resolved to redeem all of the preference shares and pay the final dividend on 30 June 20Y0. The funds for the redemption were provided by issuing 75 000 ordinary shares on 30 June 20Y0 at a premium of C0.25 per share and the balance was provided from the company's bank account. The total cash paid to the preference shareholders has been debited to "Payments to preference shareholders."

- Share issue expenses of C1 688 were incurred on the ordinary shares issued on 30 June 20Y0 but have not yet been paid. The directors want to use the share premium account to the maximum extent possible for the redemption of the preference shares and for writing off the share issue expenses.

- The company issued 200 C1 000 14% debentures on 1 July 20X7 at 95% of their face value. Interest is payable semi-annually in arrears on 1 January and 1 July. The debentures are secured by a mortgage over land worth C300 000 and were issued at an effective interest rate of 15.918% compounded semi-annually. The debentures are redeemable at par on 31 December 20Y0.

- On 1 March 20X8 a loan of C150 000 was obtained from Investments Bank, which bears interest at 13% p.a. payable annually in arrears on 28 February. The loan is repayable in five equal annual installments commencing 1 March 20Y0.

- At the annual general meeting the directors were granted a general authority to issue any unissued shares at their discretion at any time before the next annual general meeting.

- The directors declared a final ordinary dividend of C0.10 per share on 31 July 20Y0. The financial statements were authorised for issue on 5 August 20Y0 by the board of directors.

- There are no components of other comprehensive income.

Required:

To the extent the information allows, prepare the statement of comprehensive income, statement of changes in equity and statement of financial position notes of Scott Limited for the year ended 30 June 20Y0, in terms of International Financial Reporting Standards and the Companies Ordinance, 1984.

Accounting policies, dividends per share disclosure and comparative figures are not required.

Part 5

Chapter 21
Non-current assets held for sale and discontinued operations

Question	Key issues
Section A	**Non-current assets held for sale**
21.1	Non-current asset held for sale: prior measurement under the cost model: journals and disclosure (with and without tax)
21.2	Non-current asset held for sale: prior measurement under the cost model: journals and disclosure (with and without tax)
21.3	Non-current asset held for sale: prior measurement under the cost model: journals and disclosure (with tax)
21.4	Non-current asset held for sale: prior measurement under the revaluation model: journals and disclosure (with and without tax)
21.5	Non-current asset held for sale: prior measurement under the revaluation model: journals and disclosure (with and without tax)
Section B	**Discontinued operations**
21.6	Understanding the identification of a discontinued operation
21.7	Understanding the disclosure of information relating to discontinued operations, disclosure of the note to the discontinued operation
21.8	Statement of comprehensive income, note and tax implications of discontinued operation
21.9	Brief discussion and disclosure of statement of comprehensive income, note and tax implications of discontinued operation
21.10	Discussion components and disposal groups and disclosure of statement of comprehensive income, statement of changes in equity, statement of financial position and notes to the discontinued operation, (with tax adjustments)
21.11	Statement of comprehensive income, and notes on the discontinued operation, (with tax adjustments) and discussion of investment properties held for sale
21.12	Discussion of the raising of provisions in respect of retrenchment packages

Question 21.1

Eradicate Ltd owns only one item of property, plant and equipment being plant, which it has always carried under the ***cost model***, details of which follow:

Cost (1 January 20X1)	C500 000
Depreciation	20% pa straight-line to a nil residual value
Recoverable amount (31 December 20X2)	C210 000

On 1 April 20X3, the company decided to sell the plant. All the criteria necessary for reclassification as a non-current asset held for sale were met on this date. The following information was relevant on this date:

Fair value	C200 000
Costs to sell	C10 000
Value in use	C160 000

At 31 December 20X3 (the company's year-end) the following information was relevant:

Fair value	C300 000
Costs to sell	C10 000

Required:

Part A:

Ignoring tax:

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X3. Accounting policies are not required.

Part B:

Assume the following information regarding tax:

- The tax authorities allow a wear and tear deduction of 25% of cost (not apportioned).
- The normal income tax rate is 30%.

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X3. Tax and accounting policies notes are not required.

Question 21.2

Outahere Ltd owns only one item of property, plant and equipment being plant, which it has always carried under the ***cost model***, details of which follow:

Cost (1 January 20X1)	C500 000
Depreciation	20% pa straight-line to a nil residual value
Recoverable amount (31 December 20X2)	C210 000

- On 1 April 20X3, the company decided to sell the plant. All the criteria necessary for reclassification as a non-current asset held for sale were met on this date. The following information was relevant on this date:

Value in use	C200 000
Fair value	C200 000
Costs to sell	C10 000

- At 31 December 20X3 (the company's year-end) the following information was relevant:

Fair value	C180 000
Costs to sell	C10 000

Required:

Part A:
Ignoring tax:

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X3. Accounting policy notes are not required.

Part B:
Assume the following information regarding tax:

- The tax authorities allow a wear and tear deduction of 25% of cost (not apportioned).
- The normal income tax rate is 30%.

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X3. Tax and accounting policy notes are not required.

Question 21.3

Jovial Ltd owns only one item of property, plant and equipment being a machine. Jovial Ltd purchased this machine at a cost of C250 000 on 1 January 20X5. It has always carried this machine under the cost model.

On 1 April 20X7, the company decided to sell the machine and all the necessary criteria to reclassify the machine as a non-current asset held for sale were met.

- The machine is expected to have a useful life of 5 years.
- The tax authority allows the machine to be deducted over 4 years (not apportioned).
- The machine had the following values:

31 December 20X6: recoverable amount	C105 000
1 April 20X7: fair value less costs to sell (value in use: 90 000)	C 95 000
31 December 20X7: fair value less costs to sell (value in use: 105 000)	C145 000

- The normal income tax rate is 30%.

Required:

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X7. Notes relating to tax and accounting policies are not required.

Question 21.4

Tossout Ltd owns only one item of property, plant and equipment being plant, which it has always carried under the ***revaluation model***, details of which follow:

Cost (1 January 20X1)	C500 000
Depreciation	20% pa straight-line to a nil residual value
Fair value (1 January 20X2)	C800 000

Tossout Ltd always uses the net replacement method to account for changes in fair value.

On 1 April 20X3, the company decided to sell the plant. All the criteria necessary for reclassification as a non-current asset held for sale were met on this date. The following information was relevant on this date:

Fair value	C500 000
Costs to sell	C50 000

There was no indication that this asset was impaired.

At 31 December 20X3 (the company's year-end) the following information was relevant:

Fair value	C700 000
Costs to sell	C40 000

The company has the policy of reversing a revaluation surplus on the eventual disposal of the related asset.

Required:

Part A:
Ignoring tax:

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X3. Accounting policy notes are not required.

Part B:
Assume the following information regarding tax:

- The tax authorities allow a wear and tear deduction of 25% of cost (not apportioned).
- The normal income tax rate is 30%.

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X3. Notes relating to tax and accounting policies are not required.

Question 21.5

Cutaway Ltd owns only one item of property, plant and equipment being plant, which it has always carried under the ***revaluation model***, details of which are as follows:

Cost (1 January 20X1)	C500 000
Fair value (1 January 20X2)	C800 000
Depreciation	20% pa straight-line to a nil residual value

Cutaway Ltd always uses the net replacement method to account for changes in fair value.

On 1 April 20X3, the company decided to sell the plant. All the criteria necessary for reclassification as a non-current asset held for sale were met on this date. The following information was relevant on this date:

Fair value	C650 000
Costs to sell	C50 000

There was no evidence that this asset was impaired.

At 31 December 20X3 (the company's year-end) the following information was relevant:

Fair value	C500 000
Costs to sell	C30 000

The company has the policy of reversing a revaluation surplus on the eventual disposal of the related asset.

Required:

Ignoring tax:

a) Show all journal entries relevant to the above information.

b) Disclose the effect on the statement of financial position, related notes and profit before tax note for the year ended 31 December 20X3. Accounting policy notes are not required.

Question 21.6

Bettenwood Limited is a listed company with 31 October year-end. It has three industrial divisions - tyre manufacturing, engine blocks and body panels - located at Richards Bay,

Nelspruit and Jacobs, respectively. Management reports are available from each of the three divisions. The following matters were raised at the directors' meetings:

- **15 July 20X1:** Concern was expressed at the perpetual poor results of the tyre manufacturing division and a decision was reached, in principle, to discontinue the division.

- **25 August 20X1:** It was unanimously agreed and announced to employees, customers and creditors that the tyre manufacturing division should be discontinued by sale. Mr. Schuma, the managing director announced that negotiations to sell the entire tyre manufacturing division had been entered into with Suba Limited as part of the implementation of the disposal plan. The sale is expected to be made within a few months.

- **23 September 20X1**: Mr. Schuma reported to the board of directors that the negotiations with Suba Limited had proceeded well, and that a contract had been signed whereby the tyre manufacturing division would be sold on 5 December 20X1.

Mr. Burger, the financial director, reported to the board that the tyre manufacturing division's assets would be realised at a loss of C50 000.

Required:

Discuss whether management would be justified in treating the tyre manufacturing division as a discontinued operation, in terms of *IFRS 5: Non-current Assets Held for Sale and Discontinuing Operations*, in the financial statements for financial year ending on 31 October 20X1.

Question 21.7

The following information relates to Evergreen Ltd. The company manufactures soccer balls and hosepipes. During 20X5 it became obvious that the soccer ball division was no longer profitable. During 20X6 this segment's results deteriorated further.

The abridged information for the soccer ball division is as follows:

	20X6 **C**
Revenue	3 750
Cost of sales	1 500
Other expenses	2 700
Finance costs	135
Income tax expense	75
Inventory	600
Accounts receivable	120
Equipment	1 695
Bank overdraft	750
Head office account (Cr)	2 250

On 18 December 20X6 the board formally decided to sell the soccer ball division to a large sporting goods manufacturer at a reasonable market value within four months. At this date, the board committed to a formal plan detailing the execution of the sale.

On 10 February 20X7 the contract for the selling of the soccer ball division was signed. The buyer agreed to take over the contracts as well as the assets and liabilities of the soccer ball segment as from 1 March 20X7.

In terms of the contract, equipment is deemed to be worth C2 250 and all the other assets and liabilities are deemed to be worth their carrying amounts. No reason exists to doubt the successful fulfillment of the contract.

The financial statements at 31 December 20X6 will be approved for publication on 31 March 20X7.

Required:

a) Discuss from which financial year the information about the discontinued operation should be separately disclosed.

b) Discuss how the discontinued operation affects the format for the presentation of the financial statements of the current year and the presentation of comparative figures.

c) Disclose the note to the discontinued operation in the financial statements of Evergreen Ltd at 31 December 20X6 to comply with the minimum requirements of International Financial Reporting Standards.

Comparatives are not required.

Question 21.8

Mandos Ltd owns and manages a number of hotels. Mandos owns a number of branches situated throughout Pakistan including Faisalabad.

However, its profits from its Faisalabad division have been on the decrease due to a financial and political crisis within the country. As a result the board of directors met on 29 November 20X8, to discuss the situation regarding the Faisalabad branch. After much deliberation, the board of directors approved a formal plan to dispose of its operations within Zimbabwe. All parties concerned were immediately notified of the plan. The non-current assets were classified as held for sale on this date.

The division sold its equipment on 30 November 20X8. The remaining assets would be sold off separately. The following journal entry was recorded.

	Debit	Credit
30 November 20X8		
Bank	420 000	
Disposal		420 000
Sale of equipment		

Management estimated it will cost C90 000 to compensate the employees who will be affected. This will be paid during March 20X9 and will be allowed as a tax deduction by the tax authority in the year in which it is paid.

Fair value less costs to sell of the remaining assets at 31 December 20X8:

Inventory	59 000
Accounts receivable	39 600
Buildings	700 000
Furniture	32 000

Total useful lives of assets, and write off period allowed by tax authority (no apportionment):

Buildings (not depreciated and no tax allowance granted)	
Furniture	10 years
Equipment	10 years

There are no components of other comprehensive income.

The tax authorities allow the write down of inventory and the provision for doubtful debts as a deduction in the current year of assessment.

The normal tax rate is 30% and deferred tax must be provided for on all temporary differences.

The information relating to the Faisalabad branch is reflected in the following trial balance extract.

MANDOS LTD – FAISALABAD BRANCH EXTRACT OF THE TRIAL BALANCE AT 31 DECEMBER 20X8	
Revenue	(1 180 000)
Accounts payable	(31 200)
Disposal	(420 000)
Buildings (at cost)	600 000
Equipment (carrying amount): 1 January 20X8 - Original cost C600 000 on 1 January 20X4	360 000
Furniture (carrying amount): 1 January 20X8 - Original cost C48 000 on 1 January 20X6	38 400
Inventory	64 000
Accounts receivable	43 000
Other expenses	1 106 400
Current tax payable	(22 080)

Required:

a) Prepare the discontinued operation section of the statement of comprehensive income of Mandos Ltd for the year ended 31 December 20X8 in accordance with the requirements of International Financial Reporting Standards. Show the analysis of discontinued operations on the face of the statement of comprehensive income.

b) Disclose the notes to the discontinued operation for the current year in accordance with the requirements of International Financial Reporting Standards.

Question 21.9

Toys Aren't Us Ltd operates in two separate divisions, one that manufactures toys and another that sells soft drinks. On the 30th May 20X1, senior management decided to sell the toy division as this division was no longer profitable. On 30th June 20X1 a formal disposal plan was approved by the board of directors. The division was expected to be sold within 6 months. The carrying amounts of all assets and liabilities in the disposal group were re-measured in terms of the applicable International Financial Reporting Standard.

A sale agreement was entered into on 30 September 20X1 to sell the entire toy division for C55 000. The costs directly associated with the sale of the division would be approximately

C1 000. At that date, both parties agreed that bad debts of C1 250 should be written off and that inventory amounting to C1 250 was considered to be obsolete (tax deductions are allowed in the year the expenses are incurred).

The directors determined that the cost of employee terminations with respect to the discontinuance of the toy division would amount to C5 000. These expenses are not allowed as a tax deduction as they are directly related to the decision to discontinue the operation and therefore are not in the production of income.

None of the costs mentioned above have been included in the trial balance at the 30 September 20X1. The following is an extract of balances relating to the toy and soft drinks divisions at 30 September 20X1:

	Toys	Soft drinks
	C	C
Equipment, at carrying amount (original cost C90 000)	47 250	5 000 000
Inventory	12 500	1 125 000
Accounts receivable	7 500	875 000
Accounts payable	7 250	600 000
Income tax expense	?	1 350 000
Revenue from sales	75 000	7 500 000
Cost of sales	50 000	2 250 000
Other expenses (includes depreciation on the equipment for 9 months)	20 000	750 000

Depreciation and wear & tear are both 10% per annum. The wear and tear allowance is apportioned. At the beginning of the year, the carrying amount of the equipment was the same as the tax base. The tax rate is 30%.

There are no components of other comprehensive income.

The sale agreement was signed on 30 November 20X1.

Required:

a) Identify, with reasons, the date at which the division would be classified as 'held for sale'.

b) Prepare the statement of comprehensive income of Toys Aren't Us Ltd for the year ended 30 September 20X1 and disclose only the note to the discontinuing operation and tax in accordance with International Financial Reporting Standards. Accounting policy notes are not required.

Question 21.10

Voetstoets Ltd currently operates in two divisions, as a manufacturer of bicycles as well as a retailer of leather shoes.

The directors of Voetstoets Limited drew up a formal plan on 30 September 20X4 to dispose of the bicycle division through various transactions. On 30 November 20X4 a buyer, Mr Kamran, was found who wished to purchase the plant and equipment. On 31 December 20X4 he purchased all the plant and equipment for C168 000 cash. It was expected that the disposal of

the entire bicycle division would be completed by February 20X5. Voetstoets Ltd is not actively seeking buyers for the current assets and liabilities of the division.

Assets are expected to realise the following amounts:

	C
Accounts receivable at 31 December 20X4	156 000
Inventory at 31 December 20X4	33 000
Plant and equipment (amount paid by Mr Kamran on 31/12/20X4)	168 000

The following summarised trial balances were extracted from the books of Voetstoets Limited at 31 December 20X4.

	Total		Information relating to the bicycle division included in the total	
	20X4	20X3	20X4	20X3
	C	C	C	C
Share capital	600 000	600 000		
Retained earnings	509 895	171 885		
Revenue	3 282 000	2 334 000	582 000	601 200
Accounts payable	67 500	75 000	30 000	37 500
	4 459 395	3 180 885		
Plant and equipment at carrying amount (Historic cost of bicycle equipment: C200 000)	813 150	720 000	142 000	160 000
Inventory	263 685	156 000	42 000	81 000
Accounts receivable	168 000	192 000	168 000	192 000
Cash	229 650	116 895		
Cost of sales	2 100 000	1 400 000	420 000	350 000
Other expenses (including depreciation at 10% pa and IFRS 5 impairment on bicycle equipment)	498 300	279 700	78 300	29 200
Dividends paid	180 000	120 000		
Taxation	206 610	196 290	?	?
	4 459 395	3 180 885		

Additional information about the bicycle division

- The other expenses of C78 300 (20X3: C29 200) in the trial balance of the bicycle division include the following:

	20X4	20X3
	C	C
Redundancy packages paid to employees	24 000	-
Bad debts	6 000	12 000

- The sale of the plant and equipment has not yet been recorded. The carrying amount and the tax base of the plant and equipment were the same at the beginning of the year.

- All accounts payable balances at 31 December 20X4 will be paid by Voetstoets Limited in January 20X5.

- The continuing operations have not created any deferred tax.
- The inventory and accounts receivable adjustments and the redundancy costs were deductible for tax purposes as they were incurred.
- Taxation has been provided at a rate of 30%. The taxation authorities provide for wear and tear at 10% p.a. (not apportioned).
- Assume that dividends carry no tax consequences.
- There are no components of other comprehensive income

Required:

a) Discuss whether the bicycle division can be classified and presented as:

   i) a discontinued operation
   ii) a disposal group held for sale

b) Prepare the statement of comprehensive income, statement of financial position and statement of changes in equity of Voetstoets Limited for the year ended 31 December 20X4, in accordance with the requirements of International Financial Reporting Standards. No notes are required.

c) Disclose the note to the discontinued operation and the note to the tax expense in accordance with International Financial Reporting Standards.

Question 21.11

Big Nic Ltd owns and manages a number of restaurants. The company operates through branches in all the main cities in South Africa as well as in Swaziland.

BIG NIC LTD **EXTRACT OF THE TRIAL BALANCE AT 31 DECEMBER 20X5**	**Swaziland**
	C
Revenue	590 000
Accounts payable	15 600
Disposal	210 000
Land & buildings (at cost)	300 000
Equipment (carrying amount)	152 500
- Original cost C300 000 on 01 January 20X1	
Furniture (carrying amount)	17 000
- Original cost C24 000 on 01 January 20X3	
Inventory	32 000
Accounts receivable	21 500
Other expenses	553 200
Current tax payable	11 040

The following information is relevant:

- Due to political uncertainties in Swaziland, profits earned by the division have decreased. The company decided to terminate its operations in this country as they were no longer considered to be financially viable. At a board meeting held on 1 November 20X5, the

board of directors approved formal plan for the disposal of the operations in Swaziland by selling the assets in a number of transactions. This decision was announced publicly immediately after the meeting. The non-current assets were classified as held for sale on an individual basis on this date.

- During 1 December 20X5 the division's equipment was sold for C210 000. Payment for the equipment was deposited in the bank and credited to a disposal account on this date. This was the only entry processed for the sale of the equipment.

- Management has estimated that C45 000 will have to be paid to compensate employees whose jobs will become redundant as a result of the closure of the Swaziland operations. The compensation will be paid during March 20X6 and will be allowed as a deduction by the Tax authority only in the following year of assessment.

- Management has valued the remaining assets at the following fair values less costs to sell at 31 December 20X5:

	C
Land & buildings	350 000
Furniture	16 000
Inventory	29 500
Accounts receivable	19 800

It is expected that the remaining assets will be sold and the accounts payable settled by 30 June 20X6.

- Land and buildings are not depreciated and the taxation authorities do not allow any deductions on these assets.

- Furniture and equipment are both depreciated at 10% per annum on a pro-rata basis and depreciation is included in 'other expenses'. The taxation authorities allow the same deduction, however not-apportioned.

- The taxation authorities allow the write down of the inventory and the provision for doubtful debts as a deduction in the current year of assessment.

- The applicable tax rate is 30%. Deferred tax must be provided for on all temporary differences.

- There are no components of other comprehensive income

Required:

a) Prepare the discontinued operation section of the statement of comprehensive income of Big Nic Ltd for the year ended 31 December 20X5 in accordance with the requirements of International Financial Reporting Standards. Show the analysis of discontinued operations on the face of the statement of comprehensive income. No notes are required.

b) Disclose the notes to the discontinued operation for the current year only in accordance with the requirements of International Financial Reporting Standards. Accounting policy notes are not required.

c) Discuss the implications to the financial statements if the land and buildings had been accounted for as investment property under the fair value model of IAS 40, assuming fair value of the land at the beginning of the year was the same as original cost and tax base.

Question 21.12

The directors of Drummer Limited decided in a directors' meeting in December 20X3 to sell the Bin division, one of its smaller businesses. The directors have estimated that the cost of paying retrenchment packages to the fifteen staff members will be in the order of C10 million. The accountant of Drummer Limited believes that it would be prudent to make a provision for this amount.

Required:

Discuss whether or not the accountant would be correct in making a provision for retrenchment packages in the financial statements for the year ended 31 December 20X3.

Part 5

Chapter 22
Statement of cash flows

Question	Key issues
22.1	Understanding the accounting for various items in the cash flow statement
22.2	Direct method, operating activities section
22.3	Direct method, calculation and explanation of ratios, preference share issue, debentures
22.4	Direct method, operating activities section, bad debts, deferred tax
22.5	Direct method, operating and financing activities sections
22.6	Direct method, understanding cash management, redemption of preference shares, capitalisation issue
22.7	Basic preparation on direct method
22.8	Basic preparation on direct method
22.9	Indirect method, tax and ratio analysis

Question 22.1

Discuss how the following items would be accounted for in a company's cash flow statement:

a) debenture discount written off

b) goodwill being impaired

c) deferred taxation included in the statement of comprehensive income tax charge

d) an under-provision of taxation in the previous year

e) share issue expenses of C2 000 incurred during the year of which C1 000 is written off against share premium.

Question 22.2

Hickory Limited manufactures clocks, which it sells to retailers around the country. The following balances were extracted from its financial statements for the years ended 31 July 20X5 and 20X6 respectively:

	20X6	20X5
	C	C
Revenue	3 000 000	2 000 000
Cost of sales	2 000 000	1 300 000
Profit for the period	390 000	240 000
Plant and equipment	500 000	450 000
Accumulated depreciation - plant and equipment	50 000	45 000
Inventory	340 000	348 500
Accounts receivable	450 000	400 000
Provision for doubtful debts	25 000	18 000
Trade payables	250 000	235 000
Accrued expenses	15 000	-
Current tax payable	2 000	1 500

Additional information

- New plant costing C90 000 was purchased during the year. Plant with a carrying amount of C10 000 was sold during the year at a profit of C5 000.
- The tax rate is 40%. The depreciation expense equals the tax allowances granted by the taxation authorities.

Required:

a) Prepare the operating activities section of the cash flow statement for the year ended 31 July 20X6 using the direct method.

b) Prepare a reconciliation between profit before tax and cash generated from operations.

Comparatives are not required.

Question 22.3

Olbas Limited was incorporated in 20X0 with an authorised share capital of 1 000 000 ordinary shares of C 5 each and 500 000 10% non-redeemable preference shares with a par value of C0.50 each.

The statement of comprehensive income, statement of changes in equity and statement of financial position for 30 September 20X7 year are shown below:

OLBAS LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 SEPTEMBER 20X7

	C
Revenue	3 500 000
Cost of sales	(2 450 000)
Gross profit	1 050 000
Dividends income	3 200
Operating expenses	(339 950)
Finance cost	(136 268)
Profit before tax	576 982
Income tax expense	(177 888)
Profit for the period	399 094
Other comprehensive income	0
Total comprehensive income	399 094

OLBAS LIMITED
EXTRACT FROM STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR 30 SEPTEMBER 20X7

	Retained earnings
Balance 1/10/20X6	360 755
Total comprehensive income	399 094
Transfers to non-distributable reserve	(70 000)
Dividends - Ordinary	(225 000)
- Preference	(25 000)
Balance 30/9/20X7	439 849

OLBAS LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 30 SEPTEMBER 20X7

	20X7 C	20X6 C
ASSETS		
Non-current assets		
Land and buildings	1 750 000	2 200 000
Equipment at carrying amount	312 000	280 000
Equipment at cost	480 000	400 000
Accumulated depreciation: equipment	(168 000)	(120 000)
Vehicles at carrying amount	300 000	
Vehicles at cost	360 000	
Accumulated depreciation: vehicles	(60 000)	
Investments	370 000	250 000
Current assets	407 900	375 100
Inventory	146 000	131 200
Accounts receivable	135 350	147 200
Prepaid expenses	6 300	5 960
Tax Refundable		6 440
Bank	120 250	84 300
	3 139 900	3 105 100
EQUITY AND LIABILITIES		
Capital and reserves	2 007 549	1 585 755
Ordinary share capital	1 225 000	1 225 000
Preference share capital	250 000	
Share premium	22 700	
Non distributable reserve	70 000	
Retained earnings	439 849	360 755
Non-current liabilities	773 113	1 151 845
16% Mortgage bond	250 000	625 000
20% Debentures	523 113	526 845
Current liabilities	359 238	367 500
Accounts payable	96 350	142 500
Interest payable	100 000	100 000
Current tax payable	12 888	
Shareholders for dividends	150 000	125 000
	3 139 900	3 105 100

The following information is relevant:

- During the year ended 30 September 20X7 500 000 preference shares were issued at C0.55 per share. Share issue expenses of C2 300 were paid, these expenses were written off in such a way as to maintain maximum distributable reserves. The preference shares are not redeemable.

- The 20% debentures consist of 5 000 debentures of C100 each. On 1 October 20X5 Olbas Limited had issued the debentures at 106%. The debentures are all repayable on 30 September 20Y1 at par. Interest is payable on 1 October each year. The debenture premium is amortised using the effective interest rate method.

During the year the following transactions relating to non-current assets and investments took place:

- Land and buildings were sold for C520 000. No further sales or purchases were made and the profit on sale has been transferred to a non-distributable reserve.
- Investments, which cost C125 000 were sold at a profit of C12 450.
- Both these amounts are included in the 'profit before tax'.
- No equipment was sold during the year.
- Accounts receivable are reflected on the statement of financial position net of a provision for doubtful debts of C5 640 in 20X7 and C6 133 in 20X6.
- There are no components of other comprehensive income.
- The rate of normal tax is 35%.

Required:

a) Prepare the cash flow statement of Olbas Limited for the year ended 30 September 20X7 using the ***direct*** method in terms of IAS 7. *Notes to the cash flow statement* ***are*** *required.*

b) Prepare a reconciliation between the profit before tax and the cash generated from operations.

c) Calculate the following ratios

- Return on investment ratio (ROI/ROA), defining return as profit after tax but before finance charges
- Return on equity ratio (ROE)

Compare the return on investment and the return on equity and discuss whether the company is using gearing effectively.

Comparatives are not required.

Question 22.4

The financial director of Mt Grace Limited is in the process of preparing the cash flow statement for the year ended 30 June 20X5. She has prepared a set of working papers and notes, as set out below:

Sales for year = C5 200 000

	30/06/X5	30/06/X4
Accounts receivable	845 000	720 000
Provision for doubtful debts	71 500	34 000

Remember the TB shows a total debit in respect of bad debts of C55 500

	30/06/X5	30/06/X4
Accounts payable	510 000	340 000
Inventory	305 000	210 000

Profit before tax = ~~C720 000~~ ~~C540 000~~ C680 000

Don't forget to take into account the redeemable preference shares. They were issued at par of C200 000 on 1 July 20X2 and are subject to compulsory redemption by the company on 30 June 20X7 at a premium of 4%. The nominal interest rate is 12%. The dividends have been paid on 30 June each year. Note that the premium accrued is not deductible for tax purposes.

	30/06/X5	30/06/X4
Shareholders for ordinary dividend	35 000	30 000

We did not declare an interim dividend during the current year. The final dividend of C35 000 was declared on 25 June 20X5

I know that deferred tax is one of your hottest topics, but I have prepared the following schedule relating the plant and equipment that needs to be incorporated into the taxation calculation.

		Carrying amount	Tax base	Temporary difference	Deferred tax
01/07/X2	Cost	800 000	800 000		
30/06/X3	Depreciation / tax allowance	(100 000)	(320 000)		
30/06/X4	Depreciation / tax allowance	(100 000)	(160 000)		
		600 000	320 000	280 000	81 200
30/06/X5	Depreciation / tax allowance	(100 000)	(160 000)		
		500 000	160 000	340 000	98 600

	30/06/X5	30/06/X4
Tax Payable (Current tax)	125 175	190 000

Don't forget the current normal tax rate is 29%

There are no permanent or temporary differences other than those apparent from the above information.

Required:

Prepare the operating activities section of the cash flow statement of Mt Grace Limited for the year ended 30 June 20X5, using the direct method.
Notes are not required

Question 22.5

Shine Limited manufactures furniture oils products, which it sells to retailers around the country. The following balances were extracted from its financial statements for the years ended 30 June 20X3 and 20X4 respectively:

SHINE LIMITED EXTRACT FROM STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE	20X4	20X3
	C	C
10% Redeemable preference shares	-	64 716
Retained earnings	30 741	80 000
Trade payables	8 000	10 000
Administration expenses accrued	2 000	-
Current tax payable	12 925	10 000
Shareholders for dividends	-	2 000
Inventory	111 500	131 500
Accounts receivable	90 000	20 000
Distribution expenses prepaid	3 000	2 000
Deferred tax asset	22 500	20 000

SHINE LIMITED EXTRACT FROM STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE	20X4
	C
Profit before tax	53 216
Taxation	(19 475)
Profit for the period	33 741
Other comprehensive income	0
Total comprehensive income	33 741

Additional information

- The profit before tax is stated after taking into account the following expenses:

	C
Cost of sales	120 000
Profit on sale of plant	3 000
Bad debts	1 500
Depreciation	15 000
Finance costs	15 784

- Inventory is sold at a mark up of 110% on cost.
- Dividends were declared in the current year.
- 60 000 10% preference shares (par value of C1) were subject to a compulsory redemption at a premium of ? % on 30 June 20X4. The effective rate of interest on the preference shares was 11.255%. No additional ordinary or preference shares were issued during the year.

- The finance costs comprised interest on a mortgage loan and finance costs relating to the preference shares.
- Bad debts are written off as and when they are incurred.

Required:

Prepare the *operating activities* and *financing activities* sections only of the cash flow statement of Shine Limited for the year ended 30 June 20X4, using the direct method.

Include interest and dividend payments under operating activities.
Notes are not required.

Question 22.6

Meadowvale Manufacturers Limited commenced operations in June 20X1. Its summarised financial statements for the year ended 30 September 20X7 were as follows:

MEADOWVALE MANUFACTURERS LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 30 SEPTEMBER 20X7

	20X7 C000s	20X6 C000s
ASSETS		
Non-current assets	3 024	2 795
Land and buildings	2 600	2 405
Plant and machinery	360	246
Goodwill	-	100
Unlisted investments	64	44
Current assets	2 849	1 363
Inventory	1 750	159
Accounts receivable	870	500
Listed investments	89	84
Bank	140	620
	5 873	4 158
EQUITY AND LIABILITIES		
Capital and reserves	3 477.2	3 018
Ordinary shares of C1 each	700	450
Share premium	68	72
400 000 10% redeemable preference shares of C1 each	400	500
Non-distributable reserve	164.2	120
Capital redemption reserve fund	25	50
Retained earnings	2 120	1 826
Non-current liabilities	975.8	180
Deferred tax	5.8	0
Long-term loan	970	180
Current liabilities	1 420	960
Accounts payable	670	310
Shareholders for dividend	150	180
Current tax payable	600	470
	5 873	4 158

MEADOWVALE MANUFACTURERS LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 SEPTEMBER 20X7

	C000s
Revenue from sales	5 000
Profit before tax	1 519
Income tax expense	(800)
Profit for the period	719
Other comprehensive income	
Revaluation of land and buildings	14.2
Total comprehensive income	733.2

MEADOWVALE MANUFACTURERS LIMITED
EXTRACT FROM STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR 30 SEPTEMBER 20X7

		NDR C000	Retained Earnings C000
Opening balance			1 826
Total comprehensive income		14.2	719
Transfers to	- Capital redemption reserve fund		(100)
	- Non-distributable reserve	30	(30)
Dividends	- Ordinary		(250)
	- Preference		(45)
Closing balance			2 120

Additional information

- Profit before tax was arrived at after taking the following into account:

  Bad debts - C5 000
  Depreciation on plant and machinery - C90 000
  Write down of listed investments - C7 000
  Interest paid - C92 000
  Impairment of goodwill - C100 000
  Dividends received - C18 000
  Profit on sale of land and buildings - C 50 000
  Profit on sale of plant and machinery - C 4 000
  Loss on trade in of plant and machinery - C 6 000

- On 31 March 20X7, 100 000 redeemable preference shares were redeemed at a premium of 4%. The preference shares are redeemable at the option of the company.

- On 30 April 20X7, the company made a capitalisation issue of ordinary shares, together with a fresh issue of ordinary shares at par.

- Land and buildings, with a carrying amount of C90 000, were sold at a profit of C50 000. The remaining buildings were re-valued during the year. There is no intention to sell the remaining land and buildings and the cost of land is not material. .

- There were no movements in the NDR other than those evident from the information provided. The balance at the end of 20X6 arose from transfers from retained earnings.

- The details of plant and machinery are:

	20X7	20X6
Cost	590 000	426 000
Accumulated depreciation	230 000	180 000
Carrying amount	360 000	246 000

- An item of plant, with a carrying amount of C140 000 was sold during the year at a profit of C4 000. A machine that had originally cost C60 000 and that had been depreciated by C25 000 was traded in at a loss of C6 000, in part payment of a new machine costing C100 000. The balance was paid in cash.
- In addition to the payment made in respect of the 20X6 tax liability, two provisional payments totalling C100 000 each were made during the year ended 30 September 20X7.
- There were no disposals of unlisted or listed investments during the year ended 30 September 20X7.

Required:

a) Prepare the cash flow statement and notes thereto, on the direct method, of Meadowvale Manufacturers Limited for the year ended 30 September 20X7, in conformity with IAS 7.

b) Prepare a reconciliation between profit before tax and cash generated from operations.

c) Comment on the cash management of the company on the basis of the cash flow statement you have prepared.

Comparatives are not required.

Question 22.7

The following financial statements relate to Spendee Limited:

SPENDEE LIMITED
DRAFT STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 20Y0

	20Y0 C	20X9 C
ASSETS		
Property, plant and equipment	400 000	300 000
Intangible assets	105 000	50 000
Inventory	70 000	50 000
Trade accounts receivable	20 000	30 000
Bank	0	900
	595 000	430 900
LIABILITIES AND EQUITY		
Share capital and reserves	372 100	260 900
Deferred taxation	45 000	37 000
Debentures	68 356	60 000
Trade accounts payable	52 000	42 000
Shareholders for dividends	5 000	12 000
Current tax payable	12 000	19 000
Bank overdraft	40 544	0
	595 000	430 900

SPENDEE LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 20Y0

	20Y0	20X9
	C	C
Revenue	1 750 000	1 990 000
Cost of sales	(1 392 000)	(1 791 000)
Gross profit	358 000	199 000
Other income		
Profit on sale of plant	8 000	0
Other expenses	(240 000)	(92 000)
Finance cost	(20 000)	(20 000)
Profit before tax	106 000	87 000
Income tax expense	(39 800)	(24 100)
Profit for the period	66 200	62 900
Other comprehensive income	-	-
Total comprehensive income	66 200	62 900

SPENDEE LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 20Y0

	Share capital	Share premium	Revaluation surplus	Retained earnings	Total
	C	C	C	C	C
Balance - 1 July 20X8	100 000	0	0	98 000	198 000
Profit for the period				62 900	62 900
Balance - 1 July 20X9	100 000	0	0	160 900	260 900
Profit for the period				66 200	66 200
Ordinary dividends				(30 000)	(30 000)
Revaluation surplus on land			15 000		15 000
Ordinary share issue	50 000	10 000			60 000
Balance - 30 June 20Y0	150 000	10 000	15 000	197 100	372 100

Additional information:

- Included in profit before tax are the following:

Depreciation of plant	C75 000
Depreciation of equipment	C1 644
Amortisation of development costs	?

- The company has been developing two new products (A and B) during the past few years. During the first three months of the current year, development costs incurred on product A totalled C50 000, (bringing the total development costs incurred on developing product A to C70 000). Development of product A ceased and commercial production began on 1 January 20Y0. Future economic benefits are expected to flow evenly from the sale of product A from the date on which commercial production commenced for a period of 10 years. Development costs are paid in the year that they are incurred. All development costs incurred have been capitalised.

- Plant with a carrying amount of C22 000 was sold at the beginning of the year. The company purchased extra plant during the year in order to expand the business. The revaluation surplus refers to land that was revalued on 1 July 20X9. No other purchases or sales of property, plant and equipment took place during the current year.

Required:

a) Prepare, in conformity with International Financial Reporting Standards, the cash flow statement of Spendee Limited for the year ended 30 June 20Y0, using the direct method.

b) Prepare a reconciliation between profit before tax and cash generated from operations.

Comparatives are not required.

Question 22.8

The following statement of financial position and statement of comprehensive income have been prepared for Big Foot Limited for the year ended 31 December 20X8:

BIG FOOT LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER

	Note	20X8	20X7
ASSETS		C	C
Non-current assets		762 964	510 000
Land and buildings		320 000	300 000
Plant and machinery		312 964	110 000
Development costs		130 000	100 000
Current assets		361 072	284 000
Inventories		120 000	80 000
Trade receivables		110 000	45 000
Bank		131 072	159 000
		1 124 036	794 000
EQUITY AND LIABILITIES			
Capital and reserves		493 000	450 000
Ordinary shares of C1 par value		472 000	440 000
Share premium		8 000	0
Retained earnings		13 000	10 000
Non-current liabilities		542 036	281 000
Long-term loans		527 036	260 000
Deferred taxation		15 000	21 000
Current liabilities		89 000	63 000
Trade and other payables		55 000	20 000
Current tax payable		12 000	5 000
Interest payable		4 500	9 000
Shareholders for dividends		17 500	29 000
		1 124 036	794 000

BIG FOOT LIMITED
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X8

	20X8
	C
Revenue	654 000
Cost of sales	(294 000)
Gross profit	360 000
Other income	
Profit on sale of plant and machinery	20 000
Other expenses	(347 000)
Finance costs	(17 000)
Profit before tax	16 000
Income tax expense	(3 000)
Profit for the period	13 000
Other comprehensive income	-
Total comprehensive income	13 000

Additional information:

- Included in other expenses are the following items:

Depreciation on plant and machinery	C20 222
Impairment of plant and machinery	C10 648
Amortisation of development costs (see below)	C?

- Part of the office building was extended during the year. There were no other purchases or sales during the year. Land and buildings are not depreciated. Half of the cost of the extensions were financed via a mortgage bond, (see note on Long-term loans). The balance of the cost was paid for in cash.

- Plant and machinery with a carrying value of C15 866 was sold during the year.

- Development costs relate to 2 products: Splodgets and Goodies. The development of Goodies only began during the current year, whilst the development of Splodgets had begun at the beginning of the prior year.

  - Splodgets: The company incurred a further C20 000 on developing the 'Splodget' during the current year, all of which was capitalised. Development of the 'Splodget' was completed and commercial production commenced on 1 July 20X8. Big Foot believes that sales of Splodgets will continue for a total of 24 months, (i.e. no sales are expected after June 20Y0).

  - Goodies: Development of Goodies began during the current year with all costs incurred being capitalised. Commercial production of the Goodies is expected to commence in July 20Y1.

- The company issued 32 000 ordinary shares at C1.25 each.

- Ordinary dividends of C10 000 were declared during the year.

- C80 000 was repaid to Sub-standard Bank, the provider of the long-term loan. A portion of the balance at 31 December 20X8 relates to a mortgage bond from Sub-standard Bank that was raised during the year in order to cover half of the cost of the additions to the office building, (see note above).

- Assume that all transactions are for cash unless otherwise indicated.

Required:

Prepare the cash flow statement of Big Foot Limited for the year ended 31 December 20X8, using the direct method, in conformity with International Financial Reporting Standards

Comparatives are not required.

Question 22.9

Sauron Steel Limited is a company that manufactures and wholesales pure aluminium steel rings and rods used in the construction industry. The main income of Sauron Steel Limited is derived from the sale of their indestructible rings and accounts for approximately 90% of revenue. The company has been in operation for three years and has a 31 December year-end. The following are extracts of the financial statements for the year ended 31 December 20X2.

SAURON STEEL LIMITED
EXTRACT FROM THE STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 20X2

	C
Profit before tax	80 000
Income tax expense	(21 000)
Profit for the period	59 000
Other comprehensive income	
Revaluation of plant	105 000
Total comprehensive income	164 000

SAURON STEEL LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X2

	Share capital C	Share premium C	Revaluation surplus C	Retained earnings C	Total C
Balance at 1 January 20X1	700 000	10 000	-	25 000	735 000
Profit for the period	-	-	-	262 000	262 000
Balance at 31 December 20X1	700 000	10 000	-	287 000	997 000
100 000 Shares issued at C1.10	100 000	10 000	-	-	110 000
Share issue expenses	-	(5 000)	-	-	(5 000)
Total comprehensive income	-	-	105 000	59 000	164 000
Dividends – Interim	-	-	-	(10 000)	(10 000)
Dividends – Final	-	-	-	(10 000)	(10 000)
	800 000	15 000	105 000	326 000	1 246 000

SAURON STEEL LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 20X2

	20X2 C	20X1 C
Non current assets		
Land and buildings	1 000 000	950 000
Plant – at valuation (20X1 – at cost)	650 000	600 000
Plant-accumulated depreciation	(65 000)	(100 000)
Machinery-cost	240 000	120 000
Machinery-accumulated depreciation	(35 000)	(20 000)
Furniture and fittings - cost	50 000	50 000
Furniture and fittings - accumulated depreciation	(15 000)	(10 000)
Investments in listed companies	150 000	90 000
Current assets		
Inventories	55 000	300 000
Accounts receivable	120 000	30 000
Cash and cash equivalents	66 375	55 000
	2 216 375	2 065 000
Share capital and reserves		
Share capital	800 000	700 000
Share premium	15 000	10 000
Revaluation reserve	105 000	0
Retained earnings	326 500	287 000
Non current liabilities		
Long term loan	800 000	800 000
Deferred tax	96 000	36 000
Current liabilities		
Accounts payable	74 375	225 000
Current tax payable	0	7 000
	2 216 375	2 065 000

The profit before tax includes dividends received, depreciation and interest paid. The tax expense has been correctly calculated and includes the current *normal* tax, deferred tax and the adjustment to the prior year's tax provision.

Additional information:

- Land and buildings are not depreciated. The tax authority does not allow any deductions on the land and buildings. There were no disposals of buildings during the year.

- The plant was purchased on 1 January 20X0 for C600 000 and the useful life of the plant was estimated on that date as 12 years. The tax authority considers that the useful life is only six years and allows a wear and tear deduction accordingly.

  The plant was re-valued on 1 January 20X2 by an independent valuator. The revaluation is accounted for on the net replacement cost basis and the entity ***does not*** transfer the realised portion of the revaluation surplus to retained earnings. The useful life of the plant remained the same after the revaluation. There were no additions or disposals to plant in the year.

- There were no disposals of machinery during the year, but the entity assembled new machinery for the expansion of operations. This new machinery became available for use as intended by management on 30 June 20X2. The machinery assembled utilised C100 000 of the entity's own inventories while management paid C20 000 for external inventories and assembly costs. Machinery is depreciated over 12 years, while the tax authority allows wear and tear based on a six year useful life, apportioned for part periods.

- Furniture and fittings are depreciated at 10% per annum which is equal to its wear and tear allowance. Furniture with a carrying amount of C30 000 was exchanged for furniture of a slightly darker colour with the same fair value.

- The deferred tax balance of C36 000 as at 31 December 20X1 comprises deferred tax on plant of C30 000 and deferred tax on machinery of C6 000.

- The amount owing to the tax authorities in respect of the 20X1 year was paid in May 20X2, after taking into account the assessment from the tax authorities. The assessed tax for the 20X1 year according to the assessment amounts to C60 000. The company had made provisional payments of C55 000 in that year and had provided C62 000 in respect of current *normal* tax.

- Two provisional payments were made in August and December 20X2 equal to the amount provided for current *normal* tax.

- The company has never paid dividends prior to 20X2. The company declared and paid an interim dividend of C10 000 on 30 June 20X2 and a final dividend of C10 000 on 30 December 20X2. A dividend of C5 000 was received in March 20X2.

- Authorised share capital consists of 1 000 000 ordinary shares of C1 each.

- The share issue expenses have been paid in full.

- The long term loan is payable in 20Y0 and interest is payable at 15% per annum. The interest for the year has been paid.

- The company pays tax at 30%. Except for what is apparent above, no other temporary or permanent differences exist.

Required:

a) Prepare the *taxation expense* and the *deferred taxation* notes to the financial statements of Sauron Steel Limited for the year ended 31 December 20X2.

b) Prepare the cash flow statement of Sauron Steel Limited for the year ended 31 December 20X2 according to IAS 7 *Cash Flow Statements and* using the ***indirect method***.

c) Calculate the interest cover of Sauron Steel Limited for the year ended 31 December 20X2 and comment on whether you think it is adequate, explaining what the ratio measures.

Accounting policies are not required.

Comparatives are not required.

Notes to the cash flow statement are not required.

Part 5

Chapter 23
Borrowing costs

Question	Key issues
23.1	Specific loan with costs incurred on specific dates with investment of surplus funds; construction began after the loan was raised; construction completed before year end
23.2	General loan with costs incurred on specific dates; construction incomplete
23.3	General loan with costs incurred evenly over time; construction incomplete
23.4	General loan with costs incurred evenly over time; construction complete
23.5	Specific loan and investment of surplus funds, construction began from the date that the loan was raised and was incomplete at year end Part A: costs incurred on specific dates with investment of surplus funds and a temporary delay in construction Part B: extended delay in construction
23.6	Specific loan with costs incurred evenly; construction began from the date that the loan was raised and was complete before year end; investment of surplus funds: journals
23.7	Loans raised in a foreign currency and construction completed
23.8	Specific loan: compounding annually, payments incurred on specific days: calculations and disclosure (including tax)
23.9	Specific loans: compounding annually, payments incurred on specific days: calculations
23.10	Specific loans: compounding annually, payments incurred evenly during a period and interest on monthly opening balances: calculations
23.11	General loans: compounding annually: journals and disclosure
23.12	Specific loans and general loans combined: compounding quarterly: journals

Question 23.1

Money Limited began the construction of a new building on the 1 February 20X5. Construction costs incurred in 20X5 were paid for as follows:

	C
On 1 February	500 000
On 1 July	600 000
On 1 November	800 000

The construction of the building ended on the 1 December 20X5 when the building was complete and ready for its intended use. This building is to be depreciated over 10 years to a nil residual value using the straight-line method.

The construction was financed by a loan of C1 900 000 from Cash Limited. The loan was raised on 1 January 20X5 specifically to facilitate the construction of the building. The interest rate is 25% per annum. There were no capital repayments during the year. Surplus funds were invested at 20% per annum. The interest is compounded annually.

The building is a qualifying asset for the purposes of IAS 23.

Required:

a) Calculate the amount of borrowing costs that are eligible for capitalisation during the year ended 31 December 20X5.

b) Calculate the depreciation for the year ended 31 December 20X5.

c) Calculate the carrying amount of the buildings as at 31 December 20X5.

Question 23.2

Soccer Limited began the construction of a new stadium on the 1 January 20X5. Details of the progress payments made during 20X5 are as follows:

	C
On 1 January	300 000
On 1 April	200 000
On 1 July	250 000
On 1 September	150 000
On 1 October	200 000

The stadium was still under construction at 31 December 20X5.

The construction was financed by general borrowings within the company. General loans outstanding at any one time during 20X5 averaged C20 000 000. The interest expense incurred on these loans during 20X5 was C2 600 000.

The stadium is a qualifying asset as defined by IAS 23. Interest is payable (compounded) annually.

Required:

a) Calculate the amount of borrowing costs that may be capitalised to the stadium during the year ended 31 December 20X5.

b) Calculate the depreciation for the year ended 31 December 20X5.

c) Calculate the carrying amount of the stadium as at 31 December 20X5.

Question 23.3

Rugby Limited began the construction of a new stadium on the 1 January 20X5. Details of the progress payments made during 20X5 are as follows:

	C
1 January 20X5 – 30 April 20X5	600 000
1 May 20X5 – 31 August 20X5	300 000
1 September 20X5 – 31 December 20X5	900 000

The stadium was still under construction at 31 December 20X5.

The construction was financed by general borrowings within the company. General loans outstanding at any one time during 20X5 averaged C20 000 000. The interest expense incurred on these loans during 20X5 was C2 600 000. The financier compounds interest every 4 months.

The stadium is a qualifying asset as defined by IAS 23.

Required:

a) Calculate the amount of borrowing costs that may be capitalised to the stadium during the year ended 31 December 20X5.

b) Calculate the depreciation for the year ended 31 December 20X5.

c) Calculate the carrying amount of the stadium as at 31 December 20X5.

Question 23.4

Yoodle Limited is in the process of constructing a factory building for its own use. At 31 December 20X4, a total of C450 000 had already been capitalised to the cost of the factory building.

Cash flow was becoming tight near the end of December 20X4 and therefore, in order to have sufficient resources available to the company, Yoodle Limited raised an additional loan of C400 000, costing interest of 15% per annum (effective from 1 January 20X5). This loan is to be used for a variety of purposes (it has not been raised specifically for the building costs). Yoodle Limited had an existing general loan at 1 January 20X5 of C800 000, costing interest of 10% per annum. There are no other loans. No repayments on either loan were made during 20X5 or 20X6. Interest is compounded annually.

Interest income was earned on the investment of funds from the general loans that were surplus to requirements. Interest income earned was as follows:

	C
Year ended 31 December 20X5	45 000
Year ended 31 December 20X6	92 000

The following construction costs were incurred during 20X5 (these were paid evenly over each month):

	C per month
1 January – 31 July (7 months)	70 000
1 August – 30 November (4 months)	40 000
1 – 31 December (1 month)	90 000

No construction costs were incurred during 20X6 although the builders laid a concrete slab around the base of the building on 29 January 20X6. This slab required a month to 'cure' with the result that the building could not be brought into use until 1 February 20X6. This delayed the installation of factory equipment, with the result that the factory was only brought into use on 1 March 20X6.

The building is expected to have a useful life of 10 years and a nil residual value. The straight-line method of depreciation is considered to be appropriate.

The building is a qualifying asset as defined by IAS 23.

Required:

Show the journal entries related to the above information in the books of Yoodle Limited for the year ended 31 December 20X5 and 20X6 and provide as much disclosure as is possible for the year ended 31 December 20X6. *Ignore tax.*

Question 23.5

Hockey Limited borrowed C2 000 000 (at an interest rate of 14%) from the Bank of Ball on 1 January 20X5. These funds have been borrowed in order to build a hockey stadium.

Progress payments made in 20X5 are as follows:

	C
On 1 January	600 000
On 1 July	1 200 000
On 1 September	200 000

The surplus funds were invested in a fixed deposit earning interest at 10% per annum.

The interest on both the fixed deposit and the loan are compounded annually (31 December).

Construction began on 1 January 20X5 and was still incomplete on 31 December 20X5. Between 1 June and 20 June, construction ceased while concrete cured (a necessary part of the construction process).

The stadium is a qualifying asset as defined by IAS 23.

Required:

a) Calculate the amount of borrowing costs that may be capitalised to the hockey stadium cost account in the year ended 31 December 20X5.

b) Calculate the amount of borrowing costs that may be capitalised to the hockey stadium cost account in the year ended 31 December 20X5 assuming that construction could not

begin due to the building plans not meeting municipal standards. The plans have been re-submitted and it is expected that the municipality will give the go-ahead to begin construction in early 20X6.

Question 23.6

On 1 January 20X5, Junk Limited issued 1 million C5 debentures. The debentures are compulsory redeemable on the 31 December 20X9, at C7 each. They bear interest at 12%, payable annually. The effective interest rate is 17.6319%. These funds are to be used exclusively for the construction of a head office building.

Construction of the head office began on 1 January 20X5. Junk Limited spent C2 700 000 on the construction thereof (this was incurred evenly over the period of construction).

Construction was complete and the building was ready for use on the 30 November 20X5. The useful life of the building was 10 years and the residual value is estimated at C1 000 000. Surplus funds from the debenture issue were invested and earned interest of C250 000 (earned evenly during the year).

The head office is a qualifying asset as defined by IAS 23.

Required:

Provide all the related journal entries for the year ended 20X5. *Ignore tax.*

Question 23.7

Jellyvog Limited is a company based in Paris. On 1 January 20X8 it began the construction of a new shopping mall in America.

Details of the progress payments made during 20X8 are as follows:

	Costs in $
On 1 January	200 000
On 1 April	300 000
On 1 July	550 000
On 30 September	350 000

The construction of the shopping mall (considered to be a qualifying asset) was completed on 30 September 20X8 and it was let out to tenants on the same day.

The construction was financed by a foreign loan of $1.5 million raised on the 1 January 20X8 (raised specifically to finance the mall construction). The interest rate on this loan was 15% per annum. The loan and related interest was repaid on 31 December 20X8. Surplus funds were invested in a dollar-denominated call account earning 10% interest per annum. Interest income on this account accrues annually. The balance in the dollar-denominated call account was transferred to the company's Euro-denominated call account on 31 December 20X8.

Jellyvog Limited uses the Euro as their functional currency. The average Euro/ Dollar exchange rates during 20X8 were as follows:

	Euro		Dollar
Average rates in 20X8:			
1 January – 31 March	6.00	:	1
1 April – 30 June	4.00	:	1
1 July – 30 September	7.00	:	1
1 October – 31 December	8.00	:	1
1 January – 31 December	6.25	:	1
Spot rates in 20X8:		:	1
1 January	5.00	:	1
31 March	6.10	:	1
30 June	3.60	:	1
30 September	7.20	:	1
31 December	7.00	:	1

Required:

a) Calculate the amount of borrowing costs that may be capitaliased to the shopping mall during the year ended 31 December 20X8.

b) Journalise the above

c) Calculate the amounts to be expensed or included as income in the statement of comprehensive income for the year ending 31 December 20X8 assuming that the shopping mall was not considered to be a qualifying asset.

Ignore tax.

Question 23.8

A loan of C500 000 was raised on 1 January 20X5. This loan was raised specifically to fund the construction of a building (a qualifying asset). Interest of C50 000 is charged on this loan (10% per annum) and is compounded annually on 31 December.

Interest income of C30 000 was earned evenly during the year. Included in this amount is C9 000 earned by investing surplus funds from the specific loan in a fixed deposit between 1 July – 30 September.

Construction began on 1 March 20X5 and ended 31 August 20X5.
Construction costs totalled C410 000 during this period.

The building was brought into use on 1 October 20X5. Buildings are depreciated at 10% per annum, straight-line to a nil residual value.

The company owns only one other item of property, plant and equipment, this being equipment with a carrying amount of C370 000 at 31 December 20X5 (C420 000 at 31 December 20X4). There have been no disposals, purchases or other movements in property, plant and equipment other than those that are evident from the information provided.

The tax authorities:

- allow interest to be deducted as it is incurred
- allow a building allowance of 5% per annum (not apportioned for part of a year)
- levy normal income tax at 30% of taxable profits.

There are no other temporary differences other than those evident from the information above.

Required:

a) Calculate the amount of borrowing costs that must be capitalised in terms of IAS 23.

b) Show all related journal entries in 20X5.

c) Provide the following disclosure in the financial statements for the year ended 31 December 20X5 in as much detail as is possible:

- Statement of comprehensive income
- Statement of financial position
- Accounting policy note for borrowing costs
- Finance charges note
- Profit before tax note
- Property, plant and equipment note
- Deferred tax note

No comparatives are required.

Question 23.9

Loans raised specifically to fund the construction of a building (a qualifying asset):

- Loan A (10%) raised 1 January 20X5: C500 000
- Loan B (15%) raised 1 June 20X5: C400 000

C100 000 of the loan B capital was repaid on 31 July 20X5. No other loan capital was repaid. Interest was payable (compounded) annually on 31 December.

The only interest income earned during the year was interest income earned on the investment of surplus funds from the specific loans in a 6% interest account. The interest income is not compounded.

Construction costs paid for as follows:

- 31 March 20X5: C300 000
- 31 April 20X5: C100 000
- 31 July 20X5: C220 000

Commencement date: 1 March 20X5
Cessation date: 31 August 20X5.

Required:

Calculate the amount of borrowing costs that must be capitalised in terms of IAS 23 and journalise.

Question 23.10

Loans specific to fund the construction of a building (a qualifying asset):

- Loan A (10%) raised 1 January 20X5: C500 000
- Loan B (15%) raised 1 June 20X5: C400 000

C100 000 of the loan B capital was repaid on 31 July 20X5. No other loan capital was repaid.

Interest was payable annually, compounded on 31 December.

Interest is charged/ earned on monthly opening balances.

The only interest income earned during the year was interest income earned on the investment of surplus funds from the specific loans in a 6% interest account. Interest income is not compounded.

Construction costs paid for as follows:

- 1 March 20X5 – 31 August 20X5: C630 000 (paid for evenly during this period)

Commencement date: 1 March 20X5
Cessation date: 31 August 20X5.

Required:

Calculate the amount of borrowing costs that must be capitalised in terms of IAS 23 and journalise.

Question 23.11

Yipdeedoo Limited began construction on a building, a qualifying asset on 1 March 20X1. The construction was complete on 30 November 20X1 and brought into use from 1 January 20X2. Depreciation is provided at 10% per annum to a C100 000 residual value.

The company had the following general loans outstanding during the year:

Bank	Loan amount	Interest rate	Date loan raised	Date loan repaid
A Bank	C300 000	15%	1 January 20X1	N/A
B Bank	C200 000	10%	1 April 20X1	30 September 20X1
C Bank	C100 000	12%	1 June 20X1	31 December 20X1

The interest on the loans is compounded annually.

Construction costs:

Details	Date incurred	Amount	Comments
Laying a slab	1 March 20X1	C60 000	
Waiting for slab to cure	1 March – 31 March	C0	This is a normal process
Purchase of materials	1 April 20X1	C120 000	
Labour costs	1 April – 30 Nov 20X1	C330 000	Incurred evenly over the months but paid at the *beginning* of each month

Interest income of C30 000 was earned during the year.

CHAPTERS

Part 5

Chapter 25
Employee benefits

Question	Key issues
25.1	Short-term compensated absences: journal entries
25.2	Defined benefit plan: journal entries
25.3	Profit sharing: journal entries
25.4	Short-term compensated absences, profit sharing and defined benefit plan: calculation of the employee benefit expense
25.5	Leave pay provision dealing with different conditions relating to these employee benefits: calculation of the provision
25.6	Defined benefit plan: subsidiary ledger; general ledger and disclosure
25.7	Defined benefit plan: recognition of actuarial gains/losses directly in profit and loss account and using corridor approach.
25.8	Defined benefit plan: subsidiary ledger; general ledger and disclosure
25.9	Employee benefit provisions: calculation

Question 25.1

Truck Limited is a company involved in the transportation industry. Truck Ltd employs 500 drivers, 50 managers and 10 directors.

Truck drivers work long hours, often driving through the night to ensure that Truck Limited's reputation of always being on time is maintained. As a result, truck drivers are rewarded with 40 days leave per year (more than other staff members). On average truck drivers earn C123 000 per annum.

The managers work in shifts and are comfortably accommodated at their office near the business premises. Managers are granted 30 days leave and earn an average of C212 000 per annum.

The directors are an integral part of the company, and as a result, are of the opinion that they cannot be away from work for extended periods of time. Consequently, each director only receives 20 days of leave per year. All the directors earn an annual income of C500 000.

Leave accruing to an employee during any given year, must be taken by the end of the next financial year or it will be forfeited. Leave may not be converted into cash.

Truck Limited operates on a 5 day working week. The year ended 31 December 20X6 has 365 days.

On 31 December 20X6, the following information was available:

	Average unused days	Number of employees expected to leave in next financial year *	Average number of days that will be taken in next financial year *
Drivers	10	50	4
Managers	7	3	3
Directors	5	0	2

* Employees are expected to leave early in 20X7 and will not take their leave.

Required:

a) Determine the provision that would need to be raised for each type of employee.

b) Journalise the entries that would be necessary to account for paid vacation leave for the year ended 31 December 20X6.

Question 25.2

Cabrio Limited is involved in manufacturing gizmos (these are the parts used in convertibles that allow the roof to open and close). Cabrio Limited has approximately 1 000 employees, all of whom are covered by the company's defined benefit pension plan.

The following information pertains to this pension plan:

	C
Plan assets: 1 January 20X6	300 000
Plan obligation: 1 January 20X6	400 000
Current service costs	100 000
Contributions paid during the year	200 000
Expected return on plan assets	10%
Discount rate	15%
Unrecognised actuarial loss: 1 January 20X6	55 000
Benefits paid to members during the year	100 000
Plan assets: fair value at 31 December 20X6	400 000
Plan obligation: present value at 31 December 20X6	500 000

Employees are expected to work for an average of 15 years at Cabrio Limited.

Cabrio Limited utilises the 'corridor approach' (described in IAS 19) to account for its unrecognised actuarial gains and losses.

Required:

Prepare the journal entries to account for the defined benefit plan in terms of the requirements set out in IAS 19.

Question 25.3

Futon Limited is a company involved in the retailing of sleeper couches. Futon Limited's staff complement comprises of 40 sales representatives.

Each year the sales representatives are given a gross profit target to meet. If the sales representatives surpass the target, 20% of the amount above the target is distributed to them as a bonus. The only conditions are that the sales representatives must remain employed for the entire year in which the profit was attained and remain with Futon Limited until the end of the financial year after the year in which the profit was attained.

The target for the year ended 31 December 20X3 was a gross profit of C1 000 000. The sales representatives managed to double this target.

Employment statistics reflect that:

- all employees work for Futon for at least 2 years; and
- an average of 10% of staff members leave annually and are replaced by new staff members.

Required:

a) Calculate the provision that needs to be raised at 31 December 20X3.

b) Journalise the raising of the provision.

Question 25.4

Tigger Limited is a company that is involved in the tourism industry. Tigger Limited specialises in overnight game drives. The directors of Tigger Limited believe that the most important asset in any company is the employees of the company. As such they have a number of benefits for their employees.

Vacation leave:

- All staff members are entitled to 20 days of paid leave annually.
- This leave can accumulate indefinitely, but is forfeited when an employee leaves the company. The leave may never be converted to cash.
- In total, there are a total of 320 leaves days outstanding at 31 December 20X6, which were earned in the current year.
- However, 10 staff members will be leaving on 2 January 20X7. Their leave details are as follows:
  - On 31 December 20X5: a total of 20 days leave was due to them.
  - On 31 December 20X6: a total of 40 days leave due to them.

Bonuses:

- Every year Tigger Limited pays out 10% of their profit to its employees. The profit is shared amongst the number of employees employed at year-end.
- The only condition is the employee had to be employed at Tigger Limited for the entire year. If an employee is not employed for the entire year, he forfeits his share of the profit. The forfeited profit is not distributed amongst the other employees.
- Employees are very loyal to the company with employees spending a minimum of 5 years with the company.
- On 26 July 20X6, Tigger Limited hired 5 new employees. No employees left during the current year.
- The profit for the year ended 31 December 20X6 was C5 000 000.

Defined benefit plan:

- Details of the defined benefit pension plan during 20X6:

	C
Current service cost	250 000
Benefits paid to members	500 000
Return on plan assets	50 000
Contributions paid to the fund	400 000
Finance charges on plan obligation	90 000
Actuarial gain realised during the year	10 000

General:

- At year end Tigger Limited had a total staff complement of 80 employees

- The average annual salary is C250 000.
- There are 250 working days in a year.

Required:

Calculate the amount that will be charged to staff costs (employee benefit expense) in the statement of comprehensive income.

Question 25.5

Tiff Limited has a 31 December year end. Employees work a 5 day week.

Each employee is entitled to 20 paid working days of vacation per annum.

Employee statistics are as follows:

Number of employees	50 000
Average annual salary: 20X5	C100 000
Unused leave 31/12/20X5	10 days
Leave taken in the year ended 31/12/20X6:	14 days
• S1&S2: on average, 9 earned in 20X6, 5 earned in 20X5	
• S3: all earned in 20X6	
Forecasted leave to be taken during 31/12/20X7:	15 days
• S1&S2: on average, 12 earned in 20X7, 3 earned in 20X6	
• S3: all earned in 20X7	

Additional information:

- No employees left or joined the company in the past 2 years.
- Salaries increased by 20% on the 1/1/20X6.
- Past estimates show that management is able to correctly forecast the number of vacation days that will be used in the following financial year.

Required:

Determine the leave pay provision at the 31 December 20X6 assuming that:

a) scenario 1: leave accumulates and vests indefinitely.

b) scenario 2: leave accumulates for one year after it accrues but is non-vesting.

c) scenario 3: leave does not accumulate and is non-vesting.

Question 25.6

The following details relate to Ryan Limited's defined benefit pension fund:

	C
Fair value of plan assets (1/1/20X6)	6 000 000
Fair value of the plan assets (31/12/20X6)	6 500 000
Present value of the plan obligation (1/1/20X6)	(7 000 000)
Present value of the plan obligation (31/12/20X6)	(7 600 000)
Unrecognised past service costs (1/1/20X6; vesting on the 31/12/20X9)	400 000
Current service costs (accrues evenly)	1 500 000
Payments made to the fund (30/6/20X6)	1 000 000
Benefits paid by the fund (30/6/20X6)	(1 100 000)
Unrecognised actuarial gains (1/1/20X6)	(750 000)
Expected return on plan assets (1/1/20X6)	12%
Expected return on plan assets (31/12/20X6)	15%
Rate on long term high quality bonds (1/1/20X6)	10%
Rate on long term high quality bonds (31/12/20X6)	12%
Average remaining working life of employees	10 years

Ryan Limited wishes to use the corridor provisions in IAS 19 to minimise the impact of actuarial gains and losses on the statement of comprehensive income.

Required

a) Show all ledger accounts related to this defined benefit plan in the pension fund subsidiary ledger of Ryan Limited for the year ended 31 December 20X6.

b) Show the pension fund liability (or asset) account in the general ledger of Ryan Limited for the year ended 31 December 20X6.

c) Prepare the related notes to the financial statements of Ryan Limited for the year ended 31 December 20X6 in accordance with IFRSs.

Question 25.7

The details for the year ended 31 December 20X8 relating to the defined benefit plan that an entity provided for its employees are as follows:

PV of obligation at 31 December 20X7	700 000
Fair Value of assets at 31 December 20X7	1 000 000
Current Service Cost	295 000
Discount rate at 31 December 20X7	11.5 %
Expected return on plan assets at 31 December 20X7	12%
Contributions made to fund	300 000
Benefits paid by the fund	450 000
Average remaining working life of employees	10 years
Fair value of plan assets at 31 December 20X8	1 100 000
PV of plan obligation at 31 December 20X8	795 000

- In the year ended 31 December 20X7 existing benefits were reduced. The balance on the unrecognised past service cost account at 31 December 20X7 was C150 000. This remaining amount (C150 000) will vest over the next 3 years.

Required

a) Calculate the employee benefit expense line item in the statement of comprehensive income for the year ended 31 December 20X8 assuming that actuarial gains/losses are recognised directly in profit and loss.

b) Calculate the following as at 31 December 20X8 assuming that the IAS 19 'corridor approach' is used and that the balance on the unrecognised actuarial loss at 31 December 20X7 is C200 000:

- The total in the employee benefit expense account
- The balance on the unrecognised actuarial gains/ losses account (asset or liability).

Question 25.8

The information given below relates to the annual salary package of an employee of your business for the year ended 29 February 2008:

	C
Gross Salary	150 000
contributions (contributions by employee)	(3 000)
Pension Fund contributions (contributions by employee)	(15 000)
Employee's tax	(33 000)
Workers Union Subscription (contributions by employee)	(1 000)
Medical Aid contributions (contributions by employee)	(7 000)
Salary owing to employee	91 000

Additional Information:

- The employee works as a sales representative. He is entitled to a bonus of 10% of the gross profit of sales contracts which he arranged during the year according to a formal clause in his employment contract. The total value of all sales contracts he has organized during his 5 year employment is C5.5 mil (cost = C4.4 mil) while the value of sales arranged during the current year is C1.2 mil (cost = C0.9 mil).
- The business contributed on a 1:1 basis for medical aid and C7 500 to the pension fund for the employee's benefit.
- The business has an efficient Personnel Department that administers all deductions for all employees, paying all contributions the day after the salary is incurred.
- The employee is entitled to the standard 15 days holiday leave. This leave accumulates for one year, after which it is forfeited. It is unable to be paid out in cash upon resignation/retirement/retrenchment.
- The employee has the following leave outstanding at 28 February 20X8:

  Year ended 20X6 – 5 days
  Year ended 20X7 – 6 days
  Year ended 20X8 – 7 days

- It was expected, at 28 February 20X8, that he would use all of this leave still due to him sometime in April 20X8.

- As expected, this employee took leave in April 20X8, using up the maximum amount of past leave that was due to him.
- His monthly salary for the year ended 28 February 20X9 has remained the same as that for the year ended 28 February 20X8.
- His tax was assessed to be C35 000 for year ended 28 February 20X8 (the tax authorities posted his tax assessment to the company's address and was received 30 April 20X8). Assume that employees tax was the only tax paid by the employee.
- The appropriate discount rate is 12%

Required

a) Briefly discuss the main category of employee benefit apparent from the question above. Also list any sub-categories evident in the question above.

b) Prepare the journal entries in the records of the business for the year ended 28 February 20X8.

Note: Process the salary journal for the year as one entry and not 12 separate monthly entries. Do the same for the cash payment to employee and relevant authorities.

c) Prepare the journal entries for the utilisation of the leave as well as any salary expense (but not employer contributions) for April 20X8.

Question 25.9

You are the financial manager of Chemco Ltd, a company which researches generic medicines. One of your duties involves dealing with any aspects of IAS 19. You have the following information available to you for the year ended 31 December 20X8:

Leave Pay:

Type Of Employee	Gross Salary per year	Number of Employees	Maximum Leave Allowed per year (days)	Maximum Leave Allowed to Carry Forward (days)	Leave Taken in Current Year (days)
Directors	C350 000	8	20	15	4
Technicians	C180 000	55	18	13	11
Office personnel	C110 000	25	16	11	10

- The company policy is that all leave is accumulating for 1 year but is non-vesting.
- Experience indicates that only 40% of the directors will use the past leave due to them, while technicians and office personnel still employed in 20X9 will use 90%.
- 5 laboratory workers resigned with effect from 1 January 20X9. No other employees are expected to resign.

Maternity Leave:

- Chemco has the following number of female employees (included in the number of employees above): 6 directors, 20 laboratory workers and 16 office employees.
- Female employees are allowed 90 days paid maternity leave per annum.
- This leave is non-accumulating and is unable to be paid out in cash if not taken.

Required:

Calculate the leave pay and maternity provisions for the year ended 31 December 20X8.

Part 5

Chapter 26
Financial statement disclosure

Question	Key issues
26.1	Revaluation of depreciable asset with change in estimate of useful life
26.2	Share issue, sale of depreciable asset, tax computation, deferred tax
26.3	Journal entries and disclosure of property, plant and equipment, tax and deferred tax
26.4	Debentures, EPS, tax computation, redemption of preference shares, share issue, deferred tax, post reporting period events
26.5	Expropriation of depreciable asset, impairment of depreciable asset, tax computation, deferred tax
26.6	Separately disclosable items, calculation of tax and deferred tax
26.7	Recognition of separate components, decision to expense or capitalise, increase in provision for dismantling costs through unwinding of discount

Question 26.1

Espresso Limited is a company in the food and beverage industry. The year-end of the company is 31 December. The company purchased its only item of plant and equipment on 1 January 20X2 at a cost of C250 000. Plant and equipment is depreciated on the straight line basis over its useful life of ten years. There is no residual value. The allowance granted by the tax authorities is 20% per annum on the straight line basis.

The plant and equipment was revalued for the first time on 1 January 20X6 to a net replacement cost of C240 000. The residual value remained unchanged.

When preparing the financial statements for the year ended 31 December 20X6, the *total* estimated useful life was reassessed from ten years to twelve years. Espresso Limited accounts for changes in estimate using the re-allocation method and has a policy of transferring the revaluation surplus to retained earnings as the asset is used. The normal company tax rate is 29%.

Required:

a) To prepare the following notes to the financial statements of Espresso Limited for the year ended 31 December 20X6:

- Accounting policy for plant and equipment
- The plant and equipment note
- The deferred tax note
- The change in accounting estimate note

b) To prepare an extract from the statement of changes in equity of Espresso Limited for the year ended 31 December 20X6, showing only the revaluation surplus column.

Question 26.2

Technowiz Limited is a listed company involved in manufacturing specialised accessories for the computer industry such as a cordless keyboard and mouse, a docking station and digital pen.

The trial balance of Technowiz at 30 September 20X8 is presented below:

TECHNOWIZ LIMITED
TRIAL BALANCE
AT 30 SEPTEMBER 20X8

	Debit	Credit
Ordinary share capital (1 000 000 shares)		1 000 000
Share Premium		1 060 000
12% Preference share capital		200 000
Loan from bank		600 000
Deferred tax (30/9/X7)		79 200
Retained earnings (30/9/X7)		126 200
Gross profit		1 509 140
Operating expenses	800 000	
Land and buildings	2 600 000	
Accumulated depreciation – buildings (30/9/X7)		218 750
Equipment	1 175 000	
Accumulated depreciation –equipment (30/9/X7)		396 000
Motor vehicles	530 000	
Accumulated depreciation – motor vehicles (30/9/X7)		235 000
Investment in Data (Private) Ltd	60 000	
Loan to Data (Private) Ltd	33 000	
Inventory	68 750	
Accounts receivable	51 200	
Bank	113 550	
Accounts payable		49 210
Dividends paid	42 000	
	5 473 500	5 473 500

The following information is relevant:

- Authorised share capital comprises 1 200 000 ordinary shares of par value C1 and 400 000 non-redeemable preference shares of C0.50 each.

  The preference shares were issued on 30 June 20X6. Dividends are payable half yearly.

  On 1 January 20X8 the company had a rights issue of 1 share for every 3 ordinary shares held at C2.75 per share. An extract from the minutes of the AGM reads as follows:

  "Approved the granting of unconditional authority to the directors to issue up to 200 000 shares at any time before the next AGM"

- The loan bears interest at the prime lending rate less 2% which is payable annually in arrears on 1 October. During the current year the prime rate was as follows:

1/10/X7 - 30/6/X8	18%
1/7/X8 - 30/9/X8	20%
30/9/X8	21%

  The loan is repayable in full on 30 September 20Y1 and is secured over land.

- Land is not depreciated. Buildings are depreciated at 2% p.a. on cost, which is equal to the allowance granted by the tax authorities. Land and buildings comprise a factory situated on stand 674 Edenvale township. The land was purchased on 1 September 20X0 and a factory was constructed thereon at a cost of C1 750 000. The factory was completed and brought into use on 30 June 20X1. No land was bought or sold during the year.

- Equipment is depreciated on the straight line basis at 20% p.a. The tax authorities grant an allowance of 33.3% per year on cost. The allowance is not apportioned over time.

  On 1 January 20X8 new equipment was purchased at a cost of C185 000. This is the first addition to the existing equipment since it was purchased.

  At the end of the year management identified certain equipment whose market value had declined significantly, due to major technological advances. According to the management accountant's depreciation schedules, the equipment had a carrying amount of C66 000 on 30 September 20X8. The net selling price was estimated at C40 000 and the value in use was calculated to be C35 000. *No entries have been processed to account for the decline in value.*

  There were no sales of equipment during the year.

- Motor vehicles are depreciated at 25 % p.a. on cost, which is equal to the wear and tear allowance granted by the tax authorities. All the motor vehicles (other than the new delivery van mentioned below), were purchased on 1 October 20X5.

  On 30 November 20X7, a delivery van was involved in an accident and written-off by the insurance company. The cost price of the van was C60 000. The insurance company paid out C20 750 in terms of the claim and the bookkeeper journalised it as follows:

	Debit	Credit
Bank	20 750	
Loss on disposal	39 250	
Motor vehicles		60 000

  A new delivery van was purchased on 28 February 20X8 at a cost of C120 000.

- Details of the investment in Data (Private) Ltd are as follows:

  30 000 shares at C2 each were purchased in Data (Private) Ltd on 1 August 20X7. Data (Private) Ltd has a total of 40 000 shares in issue. The loan was advanced on 30 September 20X8. The directors consider the shares in Data (Private) Ltd to be worth C60 000.

- Inventory is accounted for on the weighted average method, and is sold at a mark-up of 50% on cost. Finished goods with a cost of C48 000 were written down to their net realisable value of C36 000 on 30 September 20X8. The write down is included in net operating profit. The carrying amount at 30 September 20X8 comprises:

Raw materials	15 150
Work-in-progress	12 600
Finished goods	41 000

- An interim dividend of C0.03 per ordinary share and the interim preference dividend were paid on 31 March 20X8. The directors declared the final preference dividend and a final ordinary dividend of C0.04 per share on 30 September 20X8. These dividends declared have not yet been recorded.

- There are no components of other comprehensive income.

- The company tax rate is 30%.

Required:

a) Prepare the statement of changes in equity of Technowiz Ltd for the year ended 30 September 20X8

b) Prepare the accounting policies and notes relevant to the statement of changes in equity and statement of financial position.

Your presentation must be in accordance with the International Financial Reporting Standards.

Comparatives are not required.

All workings must be shown.

Question 26.3

The following is the complete and correct 20X6 deferred tax calculation relating to Tissot Limited.

Property, plant and equipment		Carrying amount	Tax base	Temporary differences	Deferred tax at 30%	
Balance	01/01/20X6	400 000	480 000	80 000	24 000	A
Revaluation surplus	01/01/20X6	10 000	0	(10 000)	(3 000)	
Depreciation on plant	31/12/20X6	(12 500)	(10 000)	2 500	750	
Depreciation on buildings	31/12/20X6	(25 000)	(15 000)	10 000	3 000	
Sale of a building	20X6	(60 000)	(40 000)	20 000	6 000	
Balance	31/12/20X6	312 500	415 000	102 500	30 750	A
Telephone prepaid						
Balance	1/1/20X6	20 000	0	(20 000)	(6 000)	L
Movement	20X6	(20 000)	0	20 000	6 000	
Balance	31/12/20X6	0	0	0	0	
Rent income received in advance						
Balance	1/1/20X6	0	0	0	0	
Movement	20X6	(15 000)	0	15 000	4 500	
Balance	31/12/20X6	(15 000)	0	15 000	4 500	A

The following information is relevant:

- There are no other permanent or temporary differences other than those evident from the information provided.

- The company owns only an item of factory plant and buildings:

- At 1 January 20X6 plant had a carrying amount of C40 000, (cost of C100 000 and accumulated depreciation of C60 000) and a remaining useful life of four years as at 1 January 20X6.

- Plant is measured on the revaluation model: plant is revalued to fair value every three years, the valuation on 1 January 20X6 being its first revaluation. The net replacement value method to account for revaluations of its plant.

- Buildings are measured on the cost model.

- At 1 January 20X6, buildings had a carrying amount of C360 000, (cost of C500 000 and accumulated depreciation of C140 000).

- A building, which had cost C200 000, was sold for C300 000 on 1 May 20X6.

- The company transfers the maximum from the revaluation surplus to retained earnings on an annual basis.

- Tissot Limited had a total equity of C445 000 at 1 January 20X6, comprising share capital of C210 000 and retained earnings of C235 000. There was no movement of share capital during 20X6.

- The profit for the period has been correctly calculated at C197 000 and dividends of C17 000 were declared on 29 December 20X6.

Required:

a) Prepare all journal entries relating to property, plant and equipment, expenses prepaid, income received in advance and deferred tax that would have been processed during the year ended 31 December 20X6.

b) Prepare, in conformity with International Financial Reporting Standards, the following notes for inclusion in the financial statements of Tissot Limited for the year ended 31 December 20X6:

   - Property, plant and equipment

   - Deferred tax.

   Accounting policy notes are not required.

   Comparatives are not required.

c) Prepare, in conformity with International Financial Reporting Standards, the Statement of Changes in Equity of Tissot Limited for the year ended 31 December 20X6.

   Comparatives are not required.

Question 26.4

Woden Limited is a company listed on the Karachi Stock Exchange that distributes and sells a variety of components and devices designed to protect electrical equipment against thunder and lightning storms. The statement of financial position of Woden Limited at 28 February *20X1* appeared as follows:

WODEN LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 28 FEBRUARY 20X1

	C
ASSETS	
Non-current assets	2 400 000
Land and buildings	
- At cost	2 200 000
- Accumulated depreciation	(400 000)
Plant and equipment	
- At cost	750 000
- Accumulated depreciation	(150 000)
Current assets	268 790
Accounts receivable	182 200
Current tax receivable	1 200
Bank	85 390
	2 668 790
EQUITY AND LIABILITIES	
Capital and reserves	2 030 450
Ordinary share capital	1 000 000
Share premium	20 000
Preference share capital	400 000
Retained earnings	610 450
Non-current liabilities	517 006
10% Debentures	487 006
Deferred taxation	30 000
Current liabilities	121 334
Accounts payable	118 608
Debenture interest accrued	2 726
	2 668 790

The following information is relevant:

- The draft profit before interest and tax for the year ended 28 February *20X2* amounted to C263 763. This amount *excludes* the premium on redemption of preference shares and the share issue expenses (see below) as well as the finance costs (see below). All other operating expenses have been accounted for.

- The land and buildings are depreciated by an amount of C200 000 per annum. This is equal to the allowance granted by the tax authorities. The land and buildings were revalued at 28 February 20X2 by a member of the institute of valuers at a fair value of C2 000 000. There is no intention to sell the land and buildings. The value of the land is not material.

- The plant and equipment was purchased on 1 March 20X0. The company depreciates its plant at 20% per annum on the straight line basis. The tax authorities grant a tax allowance of 33.3% per annum on the straight line basis.

- The authorised share capital comprises 200 000 ordinary shares of C10 each and 50 000 12% redeemable preference shares of C10 each.

- The preference shares were issued on 1 June 19W9. 30 000 shares are redeemable at the option of the company on 31 May 20X1 and the balance on 31 May 20X5.

  The directors decided to exercise the option and redeem 30 000 preference shares on 31 May 20X1 at a premium of 2.5%. The premium on redemption was provided for in terms of the issue and is embodied in the company's articles of association. To provide for the redemption, 8 000 ordinary shares were issued at C11 per share. Share issue expenses of C4 000 were incurred.

  The preference dividend relating to the preference shares redeemed was paid at the date of redemption. The preference dividend on the remaining preference shares was paid at the end of the financial year.

- The 10% debentures comprise 50 000 10% secured debentures of C10 each issued at a discount of 5% on 1 September 19W8. The debentures are to be redeemed at a premium of 10% on 31 August 20X8. The debentures are secured over the property of the company.

  The financial accountant calculated the effective interest rate at 11.4502754% and has *correctly* prepared the following amortisation table relating to the debentures:

					Balance		
Date	**Interest**	**Effective interest**	**Premium**	**Discount**	**Premium**	**Discount**	**PV**
01/09/W8						25 000	475 000
31/08/W9	50 000	54 389	2 926	1 463	2 926	23 537	479 389
31/08/X0	50 000	54 891	3 261	1 630	6 187	21 907	484 280
31/08/X1	50 000	55 451	3 634	1 817	9 821	20 090	489 731
31/08/X2	50 000	56 076	4 050	2 025	13 871	18 064	495 807
31/08/X3	50 000	56 771	4 514	2 257	18 386	15 807	502 578
31/08/X4	50 000	57 547	5 031	2 516	23 417	13 292	510 125
31/08/X5	50 000	58 411	5 607	2 804	29 024	10 488	518 536
31/08/X6	50 000	59 374	6 249	3 125	35273	7 364	527 909
31/08/X7	50 000	60 447	6 965	3 482	42 238	3 881	538 356
31/08/X8	50 000	61 643	7 762	3 881	50 000	0	550 000

- On 28 February 20X2, the directors declared a capitalisation issue of one ordinary share for every two held to all ordinary shareholders registered on that date.

  On 21 March 20X2, at a meeting of directors to approve the financial statements, the directors declared an ordinary dividend of C0.10 per share for the year ended 28 February 20X2.

- In accounting for all of the above share transactions, the directors wish to maintain distributable reserves at the maximum amount possible.

- On 25 June 20X1, the tax assessment for the year ending 28 February 20X1 was received. This showed an amount of assessed normal tax on taxable profit of C30 200 for that year. An amount of C27 300 was provided in the 20X1 financial statements. The balance owing to the tax authorities was paid on 31 August 20X1, together with the first provisional payment for the 20X2 year of C14 700. The second provisional payment for the 20X2 year of C15 300 was paid on 28 February 20X2.

- The applicable tax rate is 30% .

Required:

a) Prepare the statement of comprehensive income of Woden Limited for the year ended 28 February 20X2 in compliance with International Financial Reporting Standards. Start with 'Profit before interest and tax'.

b) Prepare the statement of changes in equity of Woden Limited for the year ended 28 February 20X2.

c) Prepare the following notes to the financial statements at 28 February 20X2 in compliance with International Financial Reporting Standards:

   - Taxation
   - Deferred taxation
   - Earnings per share
   - Debenture liability
   - Property, plant and equipment
   - Post reporting period events

   Accounting policies are not required.

   Comparatives are not required (except for the earnings per share note).

Question 26.5

Coultread Cars Limited manufactures luxury cars. The company's financial year end is 31 March.

The following balances have been extracted from the general ledger at 31 March 20X0:

	Debit	Credit
Land	400 000	
Factory buildings	630 000	
Plant and machinery	850 000	
Accumulated depreciation – factory buildings		189 000
Accumulated depreciation – plant and machinery		510 000
Profit before taxation		168 000
Deferred tax		65 175
Current tax payable		4 400
Dividends paid	20 000	
Taxation expense	67 540	

- The income tax expense at 31 March 20X0 comprises:

	C
Current tax	50 400
Deferred tax	14 640
	65 040

- The tax assessment in respect of the 31 March 20X0 year end, received on 10 May 20X0, reflected an assessed tax of C51 900. A provisional payment was made on 30 June 20X0. Provisional payments made during the year ended 31 March 20X0 totalled R46 000.

- The following provisional payments were made during the year:

	C
30/09/20X0	23 000
31/03/20X1	28 900

- On 31 August 20X0 the government expropriated all the land on which all the factory buildings were situated in the Northern Province. An amount of C1 200 000 (land: C650 000 and factory buildings: C550 000) was received in compensation on 11 November 20X0. The following journal entry was recorded on receipt of the compensation:

	Debit	Credit
Bank	1 200 000	
Compensation received		1 200 000

No other entries have been processed in respect of the expropriation. No land has previously been expropriated by the government in this area.

- The factory building was built and brought into use on 1 October 19X2 and has been depreciated on the straight-line method based on an estimated useful life of 25 years. The tax authorities have granted an annual building allowance of 5% p.a. on cost. This allowance *is apportioned* for time. The tax authorities have indicated that the compensation in respect of the land is not taxable.

- The directors decided to rent a factory for the next two years until they find a suitable factory to purchase or build.

- Due to competition in the luxury car market, it has become necessary for the company to begin manufacturing its new model Prido in July 20X1 instead of September 20X2. As a result 25% of the existing plant and machinery will become obsolete and be scrapped on 30 June 20X1. Management have obtained a quotation for the scrap value of this plant and machinery amounting to C18 250 at 31 March 20X1. This plant will not be used after 31 March 20X1. No entries have been made to account for this information.

- Plant and machinery is depreciated on the straight line method at a rate of 15% per annum and an allowance of 20% p.a. on cost has been granted by the tax authorities. This allowance *is not apportioned* for time.

- Profit before depreciation and taxation for the year ended 31 March 20X1 amounted to C398 600 and includes dividends received of C15 000. An interim dividend of C10 000 was paid on 30 September 20X0. No final dividend has been declared or proposed.
- There are no components of other comprehensive income.

- The applicable tax rates for both years is 30%

Assume dividend income is exempt from tax.

Required:

To the extent that the information allows, prepare the statement of comprehensive income, statement of financial position and notes to the financial statements of Coultread Cars Limited for the year ended 31 March 20X1, in compliance with International Financial Reporting Standards.

Comparative figures are not required.

Question 26.6

Ace of Spades (Private) Limited manufactures spades in Karachi. The following balances appeared in the trial balance at 31 March 20X8:

	Debit (Credit)
	C
Deferred tax	(92 400)
Current tax payable	(3 500)
Profit before tax	(568 500)
Income tax expense	193 725
Dividends	125 000

The following information is relevant:

- The balance on deferred taxation at 31 March 20X7 was a liability of C58 800.
- On 15 July 20X8 the bookkeeper received the tax assessment for the 20X8 year of assessment, amounting to C165 000. The bookkeeper then paid the shortfall of C8 375 to the tax authorities and processed the following entry only:

	Debit	Credit
Current tax payable	8 375	
Bank		8 375

- Provisional tax payments made during the year:

30 September 20X8	C84 250
31 March 20X9	C59 350

- On 31 January 20X9 an earthquake occurred in Karachi that measured 4.9 on the Richter scale. Earthquakes have never occurred previously in this area. As a result of the earthquake the whole factory collapsed and the plant and machinery was destroyed.
- The factory building was rented and the lessor bore the loss of the factory building.
- The plant and machinery was originally purchased on 30 September 20X6 at a cost of C720 000. The company's policy is to depreciate plant and machinery at 20% p.a. on cost. The tax authorities have allowed an allowance of 33.33% on the machinery (this allowance is *not* apportioned). The plant and machinery was not insured and the loss has been accounted for in the profit before taxation for the year.
- On 1 March 20X9 the company purchased new plant and machinery, which it brought into use in another rented factory. This new plant and machinery cost C810 000 and management considers it to have a useful life of 5 years and no residual value. The tax authorities have granted an allowance of 33.33% (this allowance is *not* apportioned).
- Profit before taxation for the year ended 31 March 20X9 amounted to C376 400 and includes the effects of the earthquake.
- Dividends received during the year amounted to C18 600.
- The directors declared an ordinary dividend of C90 000 for the year ended 31 March 20X9.
- There are no components of other comprehensive income.
- The company provides for deferred tax on the comprehensive basis. The applicable tax rates are:

Normal company tax	35.0%.

Required:

Prepare extracts from the statement of financial position at 31 March 20X9, the statement of comprehensive income for the year ended 31 March 20X9 and the notes to the financial statements of Ace of Spades (Private) Limited, in accordance with International Financial Reporting Standards.

The notes in respect of property, plant and equipment are *not required.*

Comparatives and accounting policies are required.

Question 26.7

Blue Tide Ltd owns a nuclear power plant, purchased on 1 July 20X1. There is an obligation to dismantle the plant after 5 years. A condition to the continued use of the nuclear plant is a safety inspection once every 2 years. The 20X1 inspection had already been performed (on 2 January 20X1) and been paid for by the seller of the plant. The cost of this inspection is therefore built in to the price that Blue Tide Ltd paid for the plant. The next inspection is scheduled for 2 January 20X3.

Description of components:	**C**
Price paid for nuclear plant (an estimated 20% of this amount relates to the 20X1 safety inspection and the balance to the physical structure)	8 000 000
Present value of future dismantling costs (discounted at a rate of 12%)	453 942

Significant costs incurred subsequent to the purchase of the nuclear plant are listed below:

	Transaction date	**C**
• Repair of central shaft and installation of a new part (it is estimated that 40% of the invoice relates to the new part as opposed to the repair). The new part is expected to result in a 20% increase in power output, although the remaining useful life of the related plant will remain the same. The new part is expected to have a nil residual value.	1 July 20X2	500 000
• Major inspection	2 January 20X3	1 500 000

Additional information:

- The nuclear plant was ready for use from 1 July 20X1 but was only brought into use on 1 August 20X1.
- The physical structure of the nuclear plant is to be depreciated over five years to a residual value of C400 000.
- The nuclear plant must be dismantled on 30 June 20X6.
- The company uses the straight-line method to calculate depreciation.

Required:

a) Show all related journal entries relating to the nuclear plant for the year ended 31 December 20X1, 20X2 and 20X3. .

b) Disclose the nuclear plant in the 'property, plant and equipment' note in the financial statements of Blue Tide Ltd for the year ended 31 December 20X3.

Round to the nearest C1.

Ignore effects of taxation.

Part 5

Chapter 27
Government grants and assistance

Question	Key issues
27.1	Government grant to subsidise expenses
27.2	Government grant to subsidise acquisition of an asset
27.3	Government grant to subsidise the acquisition of an asset and for immediate financial support
27.4	Repayment of grant
27.5	Government grant in the form of an asset and government assistance: journals and disclosure
27.6	Government subsidy: discussion
27.7	Government grant: conditions not met and had to be repaid: change in estimate: journals

Question 27.1

Tukumu Limited is a company that manufactures curios. Tukumu Limited operates in the Natal Midlands and employs the local population to manufacture the curios.

As a result of the positive effect that Tukumu Limited has had on an otherwise impoverished area, it was awarded a government grant of C 150 000 on 1 January 20X6. This grant was given to Tukumu Limited to subsidise 20% of future wages.

Tukumu Limited had complied with all the conditions laid out to obtain the grant during the previous financial year (20X5). The only condition that remained on 1 January 20X6 is to incur future wages.

Wages incurred and paid:	**C**
31 December 20X6	200 000
31 December 20X7	250 000
31 December 20X8	400 000

Required:

a) Show the journal entries in the company's general journal, for the years ended 31 December 20X6 to 20X8, assuming that the company policy is to present such a grant as grant income.

b) Show the journal entries in the company's general journal, for the years ended 31 December 20X6 to 20X8, assuming that the company policy is to recognise government grants as an adjustment to expenses.

Question 27.2

Dozey Limited manufactures and sells toys for babies. They have been operating a profitable business for many years in the Amakanda area.

Due to a recent baby boom, Dozey Limited found it needed to purchase new equipment. At the time, the directors discovered that the government was allocating grants to manufacturing companies operating in the Amakanda area. Dozey Limited's directors applied for a grant.

On 1 January 20X5, Dozey Limited was awarded a grant of C 400 000 to purchase the much needed equipment. Dozey Limited had met all the conditions of the grant by 31 December 20X4, apart from the actual acquisition of the equipment. Dozey Limited purchased the equipment immediately on receipt of the grant (1 January 20X5).
The cost of acquiring the equipment was C 1 500 000. The useful life is expected to be 4 years. Dozey Limited does not expect to receive any amount for the equipment at the end of its useful life.

Required:

a) Show the general journal entries in the years ended 31 December 20X5, 20X6, 20X7 and 20X8. The company has the policy of recognising government grants ***directly*** in income.

b) Show the general journal entries in the years ended 31 December 20X5, 20X6, 20X7 and 20X8. The company has the policy of recognising government grants ***indirectly*** in income.

Question 27.3

Potato Limited is a company that farms corn. Potato Limited is a relatively new company in the corn industry, having previously been in the gun manufacturing industry.

Potato Limited was awarded a government grant of C 500 000 on 1 January 20X5, the details of which are as follows:

- C 300 000 is to assist with the purchase of a new harvester;
- C 200 000 is for immediate financial support and is not associated with any future costs;
- All conditions attaching to the grant have been met.

Later that day, the harvester was acquired for C 900 000. The harvester has a useful life of 5 years and, at the end of its useful life, Potato Limited expects to sell it for C 50 000 as scrap metal.

Required:

a) Show the general journal entries for the years ended 31 December 20X5 to 20X9 using the direct method (recognised as grant income).

b) Show the general journal entries for the years ended 31 December 20X5 to 20X9 using the indirect method (recognised as a reduction of the related costs).

Question 27.4

Blot Limited is a newly formed company that is considering entering the ink business. Blot plans to manufacture ink and sell it to printers.

Due to the scarcity of businesses in the sector, Blot Limited was awarded a government grant to purchase the machinery it needed to start operations.

The grant was awarded to Blot Limited on 1 January 20X6 for an amount of C 250 000 and is conditional upon Blot manufacturing ink for an unbroken period of 3 years. Should Blot stop manufacturing before the end of the 3 year period, the grant will have to be repaid in full.

Blot Limited purchased the requisite machinery on 1 January 20X6 for C 500 000. The machinery is expected to have a useful life of 4 years and a nil residual value.

Due to unforeseen circumstances, Blot Limited had to stop manufacturing ink on 1 January 20X8, but intends to continue on 1 January 20X9.

Required

a) Show the general journal entries for the years ended 31 December 20X6 to 20X9 using the direct method (recognised as grant income).

b) Show the general journal entries for the years ended 31 December 20X6 to 20X9 using the indirect method (recognised as a reduction of the related costs).

Question 27.5

Anthony Limited wanted to start manufacturing guns and weapons. To do this they were required to obtain a license from the government. The company applied for a license and was awarded one on the 30 June 20X8. The fair value of the grant is reliably determined to be worth C 900 000, and has to be renewed for this amount in 5 years time. The company had to pay the government C 50 000 to obtain the licence.

The company was also given free technical advice by government experts on the manufacturing of weapons as well as on the marketing thereof. This assistance was given because of the company's excellent BEE rating (a government imposed set of criteria that companies in that country should abide by) in its other operations.

The company has a 31 December financial year end.

Required

a) Show the journal entries for the year ended 31 December 20X8 assuming that Anthony Limited measures the licence at its fair value.

b) Show the journal entries for the year ended 31 December 20X8 assuming that Anthony Limited measures the licence at its nominal amount.

c) Prepare the disclosure necessary for the government assistance not recognised in Anthony Limited's accounting records.

Question 27.6

Trailblazer Limited recently commenced business as a shoe manufacturer. As an incentive for locating their factory in Themiddleofnowhere, the government agreed to subsidise half of the cost of the construction of the factory to the maximum of C 1 000 000.

Required:

Discuss how Trailblazer limited should account for the subsidy if the factory cost C 1 600 000 to construct.

Question 27.7

Brightspark Limited a manufacturer of light bulbs recently received a government grant of C 300 000 to assist with the company cash flows pursuant to the purchase of a glass blower for C 500 000 on 1/1/20X8. A condition placed on this grant required Brightspark to produce 10,000 light bulbs for the new parliament buildings by 31/12/20X9. Failure to comply with part or this entire requirement would cause a proportionate amount of the grant to be repayable.

- For the 20X8 financial year Brightspark produced and installed 6,000 light bulbs in the new parliament building. However due to frequent power cuts during 20X9 only 2,000 of the government light bulbs were produced and installed in 20X9.

- The useful life of the glass blower was 5 years

Required:

a) Prepare journal entries for the years ended 31 December 20X8 and 20X9, accounting for the grant and the glass blower assuming Brightspark has a policy of accounting for the grant as deferred income.

b) Prepare journal entries for the years ended 31 December 20X8 and 20X9, accounting for the grant and the glass blower assuming Brightspark has a policy of writing off the grant against the asset.

Part 5

Chapter 28
Analysis of financial statements

Question	Key issues
28.1	Interpretation of financial difficulties
28.2	Calculation of ratios to analyse working capital, working capital management
28.3	Purpose of financial statement analysis, calculation and explanation of ratios, problems and limitations of financial statement analysis, advise a potential investor

Question 28.1

A company called SA Furniture Company Limited was listed on the Karachi Stock Exchange (KSE) from 20W8 to 20X2, inclusive. In 20X3 it was eventually delisted.

The company's cash flow data for the 20W8 - 20X2 period was as follows:

SA FURNITURE COMPANY LIMITED
STATEMENT OF CASH FLOW
FOR THE YEARS ENDED

	20W8 C000	20W9 C000	20X0 C000	20X1 C000	20X2 C000
Cash flows from operating activities					
Operating cash flow before working capital changes	63 850	89 929	150 282	132 792	(130 189)
Working capital movements	(83 952)	(84 604)	(241 945)	(183 071)	197 770
Cash generated from operations	(20 102)	5 325	(91 663)	(50 279)	67 581
Finance costs and taxation	(14 342)	(20 862)	(40 985)	(77 993)	(86 987)
Dividends paid	(4 145)	(17 916)	(43 723)	(30 806)	(3 738)
	(38 589)	(33 453)	(176 371)	(159 078)	(23 144)
Cash flows from investing activities	5 169	(8 763)	(58 719)	(600)	(26 559)
Cash flows from financing activities					
Ordinary shares	26 915	-	-	-	-
Preference shares	-	58 500	104 270	(3 890)	(5 101)
Long-term loans	577	(11 029)	129 355	163 568	246 349
Short-term loans	5 928	(5 255)	1 465	-	(191 545)
	33 420	42 216	235 090	159 678	49 703
	0	0	0	0	0

The following additional non-cash flow data for the same period was also available:

	20W8 C000	20W9 C000	20X0 C000	20X1 C000	20X2 C000
Sales	729 571	934 052	1 287 052	1 409 189	1 422 727
Sales growth	-	28.03%	37.79%	9.49%	0.96%
Profit after tax	43 143	60 129	92 878	(79 224)	(77 120)
Share price at year-end	C7.20	C8.00	C12.50	C11.00	C0.40
EPS	C2.60	C3.63	C5.60	(C4.56)	(C0.43)

Required:

Comment on why you think this company experienced financial difficulties.

Question 28.2

Handyman Limited is a hardware wholesaler supplying goods to 'do-it-yourself' retailers around the country. The company commenced operations at the beginning of the 20X3 year. The company has been operating successfully for a number of years. Although turnover has increased consistently, the company has recently been experiencing cash flow problems. The managing director has approached you for advice on how to improve this situation. The following amounts were extracted from the records of the company:

	20X3	20X4	20X5
	C000s	C000s	C000s
Turnover	100 000	120 000	135 000
Cost of sales	75 000	90 000	101 250
Profit before interest and tax	6 000	5 500	5 600
Accounts receivable	16 500	25 000	29 600
Accounts payable	13 000	14 700	17 000
Inventory	18 750	26 000	30 400
Bank / (overdraft)	5 000	(500)	(2 000)

Required:

Identify and calculate the ratios that would be needed to analyse the working capital of the company. Comment on the company's working capital management in the light of these ratios.

Question 28.3

MedTech Limited is interested in acquiring a majority shareholding in Computronic Limited. As a financial analyst you are asked to undertake an evaluation of the company and suggest whether MedTech Limited should go ahead with the purchase of Computronic Limited or not. The following information is available:

Financial Statements from the company

COMPUTRONIC LIMITED
STATEMENT OF COMPREHENSIVE INCOMES
FOR THE YEARS ENDED 30 SEPTEMBER

	20X1	20X0
Sales	3 850 000	3 432 000
Cost of sales	(3 250 000)	(2 864 000)
Gross profit	600 000	568 000
Other expenses	(430 300)	(340 000)
Depreciation	(20 000)	(18 900)
Profit before finance charges	149 700	209 100
Finance charges	(76 000)	(62 500)
Profit before tax	73 700	146 600
Income tax expense	(22 110)	(43 980)
Profit for the period	51 590	102 620
Other comprehensive income	-	-
Total comprehensive income	51 590	102 620

COMPUTRONIC LIMITED STATEMENT OF FINANCIAL POSITIONS AT 30 SEPTEMBER	20X1		20X0	
ASSETS				
Non-current assets				
Property, plant and equipment		360 000		344 000
Current assets				
Inventories	836 000		715 200	
Accounts receivable	402 000		351 200	
Cash	52 000	1 290 000	57 600	1 124 000
		1 650 000		1 468 000
EQUITY AND LIABILITIES				
Capital and reserves				
Share capital	460 000		460 000	
Retained earnings	220 000	680 000	203 000	663 000
Non-current liabilities				
8% Redeemable preference shares (Redeemable on 30/09/20X3)	225 000		200 000	
Long term loan	430 000	655 000	324 000	524 000
Current liabilities				
Accounts payable	175 000		145 000	
Accrued expenses	140 000	315 000	136 000	281 000
		1 650 000		1 468 000

A download from an Information Service relating to Computronic Ltd at 30 September:

	20X1	20X0
Share price at year end (30 Sept)	C12.00	C30.00
Number of shares in issue	100 000	100 000
Dividend per share	C0.22	C0.22

Industry average data for 20X1

Current ratio	2.7 : 1
Quick ratio	1.0 : 1
Inventory collection period	52 days
Accounts receivable collection period	32 days
Non-current assets turnover	10.7 times
Total assets turnover	2.6 times
Debt : Equity ratio	100 %
Interest cover ratio	2.5 times
Profit margin	3.5 %
Return on assets	9.1 %
Return on equity	18.2 %
PE ratio	14.2

Extract of the press release issued by the company on 12 October 20X1:

> Computronic Limited is a biotechnological company that undertakes research and development of medical innovations. The company has completed trial runs of the long awaited anti-aging electronic treatment device. This device stimulates the production of high growth hormone (HGH) in your body. HGH is associated with human growth and cell health. As a mood elevator, most people find a youthful sense of wellness and a zest for life restored when their levels of human growth hormone are increased. The company's clinical evidence proves that by elevating our growth hormone levels we can significantly stop and even reverse the symptoms of aging! The electronic device has been successfully patented in Pakistan and the United States but is awaiting approval from the Food and Drug Administration (FDA), for use in the United States of America...

Required:

a) Discuss the purpose of financial statement analysis.

b) Calculate the current and quick ratios for both years and briefly analyse your results.

c) Calculate the return on equity (ROE) ratio for 20X1. Explain why this ratio will be important to MedTech Limited or any potential investor.

d) Calculate the debt to equity ratio for both years and discuss its usefulness.

e) Calculate the PE ratio for both years and discuss briefly its interpretation with particular reference to companies with high or low ratios.

f) Although financial statement analysis can provide useful information about a company's operations and its financial condition, this type of analysis has some potential problems and limitations, and it must be used with care and judgement. Discuss some problems and limitations of financial statement analysis?

g) What would your recommendation to MedTech Limited be, about their intention of buying a majority shareholding in Computronic Limited. Justify your recommendation.

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