

## FEEDBACK ON PREVIOUS EXAMINATION PAPERS

### OCTOBER / NOVEMBER 2011

#### SOLUTION 1: ACCOUNTING POLICIES, HANGERS IN ACCOUNTING ESTIMATES AND ERRORS, IAS 10 (AC107) – EVENTS AFTER THE REPORTING PERIOD 1AS12 (AC102) – INCOME TAXES AND IAS 18 (AC111) REVENUE

##### Question 1.1.

Calculation of corrected profit before Tax of rainbow Limited for the year ended 28 February 2011

	R
Provisional profit	690 000
Cash on delivery sales – reversed	(40 000)
Credit loss [ 10 000 – 0.10)	(9000)
Change in accounting estimate (300 000 / 2 – 500 000 / 5)	(50 000)
Interest – tax	(4000)
Realties – tax 2010	(6000)
<b>Corrected profit</b>	<b>581000</b>

##### Question 2

Calculation of current Tax Rainbow Limited for year ended 28 February 2011

	R
Profit before tax (see 91) above)	581 000
Exempt differences	(52 000)
Interest on tax	4 000
Penalties on tax	6000
Dividends received	(60 000)
Capital profit on sale of machine (24 000 – 20 000) x (100 – 50%)	(2000)
Temporary Differences	87 000
Cash on delivery sales	40 000
Profit on sale of machine (20 000 – 12 000)	(8 000)

Recoupment on sale of machine (20 000 – 10 000)	10 000
Depreciation (300 000 ÷ 2 )	150 000
Tax allowance (500 000 ÷ 4)	(125 000)
Royalties received in advance	20 000
<b>Taxable income</b>	<b>616 000</b>
<b>Current tax (616 000 x 28%)</b>	<b>172 480</b>

### Question 3

Calculation of deferred Tax Balance in the Statement of Financial position of Rainbow Limited as at 28 February 2011

	Carrying amount	Tax Base	Temporary Difference	Deferred Tax Asset / Liability) at 28 %
	R	R	R	R
Cash on delivery sales	40 000	-	40 000	11200
Royalties received in advance	20 000	-	20 000	5600
machinery	150 000 <sup>(i)</sup>	125 000 <sup>(ii)</sup>	25 000	(7000)
Deferred tax asset				<b>9800</b>

### Machinery carrying Amount

	R
Carrying amount : beginning of year	300 000
Depreciation (300 000 ÷ 2)	(150 000)
Carrying amount : end of year	<b>150 000</b>

**NB:** The asset is depreciated over the revised useful life.

**(ii) Machinery: Tax Base**

	<b>R</b>
Tax base : beginning of year	250 000
Tax allowance (500 000 ÷ 4)	(125 000)
Tax base - end of year	<b>150 000</b>

**Question 4**

<b>Tax Rate Reconciliation</b>	<b>R</b>
Standard tax (581 000 (1) 28%)	162680
Exempt Differences	
Interest on tax (4000 x 28%)	1120
Penalties on tax (6 000 x 28%)	1680
Dividends received (60 000 x 28%)	(16800)
Capital profit on sale of machinery (20 000 x 28%)	(560)
Adjustments to tax rate (15 080 x 1/29)	(520)
Over provision 2010 [ 20 000 – (15 000 – 4000 – 6000) ]	(15 000)
	<b>132 600</b>

**Question 5**

**Rainbow Limited**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 2011**

<b>Profit before tax</b>	<b>2011</b>	<b>2010</b>
<b>Profit after tax is stated after taking the following into account</b>	<b>R</b>	<b>R</b>
Revenue consists of:	485 000	220 000
Royalties received	560 000	
Sale of goods (250 000 + 350 000 – 40 000 40 000 + 50 000)		90 000

<b>Other income</b>		
Dividends received	60 000	20 000
Profit on realization of machinery	12 000	-
<b>Expenses</b>		
Depreciation (300 000 / 2)	150 000	
(500 000 + 20 000) ÷ 5		104 000

Included in depreciation for 2011 is a change in estimate of R50 000 ( $300\,000/2 - 500\,000/5$ ), arising from the decision to change the remaining useful life in the current year to only 2 years as the machinery had already been used to fully capacity. This change will result in decrease in depreciation in future period of R50 000.

## NOTES

### 1. Calculation of Profit before tax

Cash on delivery sales are recognized when delivery has been made and cash received. The R40 000 received on 2 February 2011 from Glow Limited was in respect of an order of paints which was only dispatched on 10 March 2011 (after year end – 28 February 2011), as such this should not be part of the sales for the current financial year.

The unrecoverable debt by stone Limited, R9000 [ $R10\,000 \times (1R - R0.90)$ ] is an adjusting event after the reporting period. The bankruptcy of a customer which occurs after reporting period usually confirms that a loss already existed on the reporting date and this should be adjusted accordingly by writing off the unrecoverable amount as a credit loss.

The change in accounting estimate results from the change in the remaining useful life. The remaining useful life of 2 years will be used to allocate the carrying amount at the beginning of the year (R300 000). This will result in depreciation of R150 000 ( $R300\,000 \div 2$ ). The original depreciation was R100 000 ( $R500\,000 \div 5$ ). The difference is the change in accounting estimate.

### 2. Calculation of current Tax

Dividends received and a portion of capital gains on profits on the sale of assets which is not taxable are exempt income.

**NB.** In the question, the capital gains tax was 50% but currently it is 66.6%. the remaining 50 % (100 – 50) is not taxable.

Penalties and interest on tax are not deductible for the tax. As a result these should be added back as they had been deducted.

The cash on delivery sales for goods delivered after year – end are taxable during the year when they are received. As a result the R40 000 cash on delivery sales deducted when we calculated profit before tax has to be added back.

SARS calculates recoupment on sale of non – current assets as the difference between the selling price and tax base of the non – current asset on date of sale. This places profit on sale assets which is not recognized by SARS, as such, this should be reversed by subtracting it. This will be the difference between the cost and carrying amount since the capital gains tax was dealt with separately.

SARS does not deduct depreciation but allows a tax allowance based on its own rules as stated in the Income Tax Act.. In this case the deductible tax allowance was over 4 years using the straight line method as opposed to our depreciation in accounting.

Income received in advance is taxed in the year of receipt according to SARS but accounting recognizes this income on royalties according to substance of agreement.

As a result, the royalties received in advance have to be added.

The current tax is calculated using the current year's tax rate.

### **Calculation of Deferred Tax**

Temporary differences may either be:

- (a) Taxable Temporary differences: These refer to temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset is recovered or when the carrying amount of a liability is settled.

**Rule 1:** When carrying amount of asset > tax base of the asset = Deferred tax liability

**Rule 2:** When carrying amount of liability < tax base of the liability = Deferred Tax liability

- (b) Deductible temporary differences: These will result in amounts that are deductible in determining taxable profit / tax loss) of future periods when the carrying amount of the asset is recovered or when the liability is settled.

**Rule 3:** carrying amount of asset < tax base of asset = deferred tax asset

**Rule 4:** Carrying amount of liability > tax base of the liability = Deferred tax asset

**Solution 2:**

**FRAMEWORK IAS8 (AC 103) – ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS, IAS10 (AC107) – EVENTS AFTER THE REPORTING PERIOD, IAS12 (AC102)- INCOME TAXES, IAS18(AC111) – REVENUE AND IAS37 (AC130) – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS**

1. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity's resources embodying economic benefits. All the criteria for an item to be classified as a liability exists if:
  - (i) There is a present obligation as a result of a past event: in this case there is a present obligation since there is a policy to refund purchases of electric shavers sold within 2 months from the date of sale to dissatisfied customers and the policy is generally known and advertised in the insert packages of the electric shavers sold.
  - (ii) This obligation should arise from past event: the past event are the sales already made to customers during the financial year.
  - (iii) The settlement of the obligation will result in outflows of cash when dissatisfied customers return an electric shavers.
  - (iv) It is possible to make a reliable estimate of the amount of the payment / outflow. In this case there is a reasonable estimate based on refund history and the sales for the year.
  - (v) This liability meets all the definition, recognition and measurement criteria. As such, a liability should be disclosed in the financial statements.

**Question 2**

**SEMINGTON LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY**

**(i) PROVISIONS FOR REFUNDS**

	<b>2011</b>	<b>2010</b>
	<b>R</b>	<b>R</b>
Carrying amount at beginning of year	25 000	-
Unused provision reversed (25 000 – 9000)	(16 000)	
Provision used during year	(9 000)	
Provision created for the year	40 000	
Carrying amount at end of year	<b>40 000</b>	<b>25 000</b>

Provision has been made for the refund of purchases of electric shavers sold within 2 months from the date of sale to dissatisfied customers. This amount will most probably be refunded to dissatisfied customers in the first two months of the next financial year.

**(ii) Contingent Liability**

During February 2011, a claim of R100 000 was instituted by Blue Cross Limited against the company for animal abuse emanating from the test of cosmetic products on animals, allegedly resulting in injury to the animals. The company's legal advisor is of the opinion that it is probable that Bemington will not be found liable of the aforementioned claim.

**(iii) Contingent Asset**

The supplier (manufacturer of electric shavers) provides a guarantee to the company for any manufacturing defects on electric shavers. At year, it is probable, but not virtually certain that R24 000 (60% of the expected R40 000 defective products) will be refunded by the manufacturer.

**Question 3**

**Bemington Limited**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 2011**

**3.1. Change in Accounting Policy**

After the financial year the company directors decided at a board meeting that the current inventory valuation method should be changed to the first – in, first – out method in order to improve the matching of revenue and expenses. This change in accounting policy was not accounted for retrospectively since the inventory valuations according to the first – in, first – out method for all the years prior to 2011 could not be determined due to a malfunction in the computer program used for the costing of inventory.

As a result, the change has been accounted for prospectively, without any adjustment against the opening balance of returning earnings. The effect of the change for 2011 is as follows.

	<b>2011 (R)</b>
Decrease in cost of sales (578 000 + 120 000) – (526 000 + 110 000)	62 000
Increase in income tax expense (62 000 x 28%)	(17360)
Increase in profit for the year	<b>44640</b>
Increase in inventory	62 000
Increase in current tax due (62000 x28%)	(17360)
Increase in equity	<b>44640</b>

#### **Question 4**

#### **BEMINGTON LIMITED**

#### **GENERAL JOURNAL – YEAR ENDED 28 FEBRUARY 2011**

	<b>R</b>	<b>R</b>
(i) Revenue (SCI) (800 000 x (100 – 40%))	480 000	
Debtors (SFP)		480 000
Cost of sales (SCI) (800 000 X 40% X $\frac{100}{125}$ )	256 000	
Inventory (SFP)		256 000
(ii) Revenue (SCI)	50 000	
Income received in advance (SFP)		50 000

#### **NOTES**



Consignment sales: revenue is recognized when goods are sold by the recipient to a third party. In this case, only 40% has so far been sold to third parties. As such the other 60% (100% - 40%) should be reversed.

The 40% goods sold should be included in cost of sales at cost price.

The gift vouchers are only recognized upon redemption.

At this point, they should be regarded as revenue received in advance.

### Question 5

#### CALCULATION OF DEFERRED TAX BALANCE FOR THE YEAR ENDED 28 FEBRUARY 2014

	Carrying Amount ( R )	Tax Base	Temporary Difference ®	Deferred Tax Asset / (Liability) 28% R
Provision for claims	40 000	-	40 000	11 200
Income received in advance	50 000	-	50 000	14 000
<b>Deferred Tax Assets</b>				<b>25 200</b>

### 3.2. Error

Correction in respect of finished goods inventory located at the Isipingo retail outlet which was excluded in inventory valuations since the 2009 financial year. The effect of the correction on the opening balance of retained earnings at the beginning of 2010 was adjusted while the comparative amounts were restated accordingly. The effect of the correction is as follows.

	2010	01/03/2009
	R	R
Increase in cost of sale (115 000 – 20 000)	(95 000)	
Decrease in taxation expense (95 000 x 28%)	26 600	
	(68 400)	
Increase in inventory	20 000	115 000
Increase in current taxation due (20 000 x 28%)	(5600)	
(115 000 x 28%)		(32 200)
Increase in equity	<b>14400</b>	<b>82800</b>

Adjustment to retained earnings at beginning of year 2010 [(115 000 x (1 – 0.28))]		<b>82 800</b>
---	--	---------------

### **3.3. Events after the reporting period**

During the first week of April 2011, finished goods with a value of R60 000 was damaged due to a burst water pipe at the Isipingo retail. The company was not insured for these damages.

## MAY / JUNE 2012

### Solution 1

#### Question 1

#### Pastry Cook Ltd

#### General Journal

	Debit	Credit
Revenue [225 000/50 x R1.20] (P/L	5400	
Deferred Income (SFP)		5400

#### Question 2

#### PASTRY COOK LTD

#### CALCULATION OF CORRECTED PROFIT BEFORE TAX IN THE STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2011

	R
Provisional tax	1250 000
Income received in advance – customer loyalty programme	(5400)
Consignment sales (70 000 x 80% x $\frac{130}{100}$ )	72 800
Consignment cost of sales (70 000 x 80%)	(56 000)
Change in accounting policy – accounting (38 000 – 25 000)	13 000
Repair of detective machines	(20000)
Fines – provisional tax	(5500)
<b>Corrected profit before tax</b>	<b>1248 900</b>

**Question 3****Pastry Cook Ltd****CALCULATION OF CURRENT TAX DUE TO SA REVENUE SERVICE FOR THE YEAR ENDED 31 DECEMBER 2011**

	<b>R</b>
Profit before tax	1248 900
Exempt Differences	(44 500)
Exempt Differences	5500
Fine for late submission	(50 000)
Foreign income	(47 600)
Temporary Differences	5400
Income received in advance – loyalty programme	44 000
Depreciation of ovens $(240\ 000 \div 208\ 000) + (720\ 00 - 60\ 000)$	(55 000)
Tax allowance – oven $(240\ 000 \div 4) \times \frac{8}{12} + (120\ 000/4) \times \frac{6}{12}$	50 000
Loss on sale of oven	
Scrapping allowance oven $[60\ 000 - (120\ 000/4 \times \frac{6}{12}) - (60\ 000 - 50\ 000)]$	(35 000)
Change in accounting policy – accounting	(13 000)
Change in accounting policy – closing inventory	38 000
Additional cost – manufacturing defects	20 000
Manufacturing defects cost incurred	(102 000)
<b>Taxable income</b>	<b>1156 800</b>
Current tax at 28%	323904
Under provision - 2010	8000
Provisional tax payments (120 000 + 110 000)	(230 000)
<b>Amount due to SARS</b>	<b>101904</b>

**Question 4****PASTRY COOK LTD****CALCULATION OF PREFERRED TAX BALANCE IN THE STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER**

	Carrying Amount	Tax base	Temporary Difference	Deferred Tax Asset / Liability at 28%
<b>2010</b>	<b>R</b>	<b>R</b>	<b>R</b>	<b>R</b>
Oven	72 000	60 000	12 000	(3360)
Inventory	445 000	420 000	25 000	(7000)
Provision for manufacturing Defects (110 000 – 28 000)	82 000	-	82 000	22 960
Deferred tax asset				<b>12 600</b>
<b>2011</b>	<b>Carrying Amount</b>	<b>Tax Base</b>	<b>Temporary Difference</b>	<b>Deferred Tax Asset / (liability) at 28%</b>
	<b>R</b>	<b>R</b>	<b>R</b>	<b>R</b>
Deferred income	5400	-	5400	1512
Oven (tax Base 240 000 – (240 000 ÷ 4 x 8/12)	208 000	200 000	8000	(2240)
				<b>(728)</b>

### Question 5

#### PASTRY COOK LTD

#### TAX RATE RECONCILIATION IN THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

	<b>R</b>
Standard tax (124 8900 x 28%)	349 692
Exempt Differences	
Fine (5500 x 28%)	1540
Foreign income (50 000 x 28% - 6500)	(7500)
Under provision of tax – prior year	8000
	<b>351 732</b>

## Question 6

### Pastry cook

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

##### (i) Change in accounting policy

After the financial year the company directors decided to change the inventory valuation method from last – in first out method to the first in, first out method as this will result in a fair presentation of the financial position and operating results of the company because of fluctuations in inventory prices. The change in policy was accounted for retrospectively and comparative amounts have been appropriately restated.

The effect of the change for 2011 is as follows:

	2011	2010	01/01/2010
	R	R	R
Decrease in cost of sales : (38 000 – 25 000) (25000 – 9000)	13000		
Increase in current tax expense (13000 x 28%) 16000 x 28%)	(3640)	16 000	
Increase in profit	<b>9360</b>	<b>11520</b>	
Increase in inventory	38 000	25 000	9000
Increase in current tax due	(10 640)		
Increase in deferred tax liability		(7000)	(2520)
	<b>27360</b>	<b>18 000</b>	<b>6480</b>
Adjustment to retained earnings at the beginning of 2010			<b>6480</b>

##### (ii) Provision for Manufacturing Defects

	2011	2010
	R	R
Carrying amount beginning of year (110 000 – 28 000)	82 000	
Provision used during year	(82 000)	(28 000)
Provision created for the year	-	110 000
Carrying amount at end of year	-	<b>82 000</b>

Provision was made in November 2010 for manufacturing defects whose repair was pledged by Pastry Cook Ltd to repair all defective biscuit machines already sold to customers. This repair was to be done free of charge and these repairs were triggered by the discovery of a material manufacturing defect in a specific range of biscuit machines. At year end, it is expected that no further costs to repair these defective biscuit machines manufactured will have to be incurred in the next financial year.

## **SOLUTION 2**

### **PART A**

- (i) Revenue is recognized when
  - (a) Significant risks and rewards of ownership are transferred;
  - (b) No continual managerial involvement or effective control associated with ownership is maintained;
  - (c) Amount of revenue can be measured reliably;
  - (d) It is probable that the economic benefits associated with the transaction will flow to the entity.
  - (e) The costs incurred or to be incurred in respect of the transaction can be measured reliably.

With regards to the sale of the laptops;

- (a) The risks and rewards of ownership have been transferred to the client – there is a full reimbursement from NCC which also offers the warrant to customers.
- (b) Malwart no longer has any managerial control associated with ownership of the computers;
- (c) The price of the laptops is given at R10 000 per laptop.
- (d) The economic benefits will flow to Malwart as there will be a reimbursement from NCC Cellular.
- (e) Costs incurred can be measured at R8000 / laptop.

As such, the sale of laptops should be regarded as revenue as it fulfills all the conditions at being recognized as revenue.

**(ii) Mallwart Ltd**

**General Journal**

	<b>Debit</b>	<b>credit</b>
	<b>R</b>	<b>R</b>
Accounts receivable (SFP) (60 X 10 000)	600 000	
Revenue (P/L)		600 000
Cost of sales (P/L) (60 X 8000)	480 000	
Inventory (SFP)		480 000
Accounts receivable (110 x 500) SFP	55 000	
Commission Receivable (P/L)		55 000
Depreciation (850 000 ÷ 5) P/L	170 000	
Accumulated depreciation (SFP)		170 000
Machinery (SFP)	850 000	
Accumulated depreciation (SFP)		170 000
Retained earnings (SFP) (850 000 – 170 000)		680 000
Provision for warranty claims (SFP)		
Warranty claims (P/L)		
[ 4% X 4600 000) + (3360 000 X 3%) + (25 00000 X 2%)] – (5% X 460 000)	103 000	
		103 000

- (iii) The R850 000 wage clock machines costs should be capitalized if it meets the definition of an asset and it should meet the criterion for recognition as per the conceptual financial Reporting.

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

In this case the wage clock machines are controlled by the company and there are probable future economic benefits to be derived from the use of the machines. The past event is the purchase of the machines and the cost can be measured reliably (R850 000).



As such the wage clock machines should be recorded as assets.

**(iv) Error**

Correction in respect of new wage clock machines installed incorrectly debited to wages in the 2011 financial year. The effect of the correction of this error on the opening balance of retained earnings at the beginning of 2011 was adjusted while the comparative amounts were restated accordingly. The effect of the correction is as follows:

	<b>2011</b>
	<b>R</b>
Decrease in expenses (850 000 – 170 000)	680 000
Increase in tax expenses (680 000 x 28%)	(190 000)
Increase in profit	<b>489 600</b>
Increase in property, plant and equipment (850 000 – 170 000)	680 000
Increase in current tax due	(190 400)
Increase in equity	<b>489 600</b>

**2. Contingent Liability**

On 31 January 2012, a claim of R400 000 was institute by the Labour Union representing Mallwart Lt’s employees against the company for not adhering to the original terms as agreed upon during the takeover of Small Cart Ltd. The original agreement required the company not to decrease their employee numbers by more than 10% and the company reduced the employee numbers by 15%, 5% more than the agreed upon rate. The company’s legal advisors are of the opinion that it is not probable that the Labour Union will be successful with their claim against Mallwart Ltd.

**3. Contingent Asset**

In February 2012 the company instituted a claim of R740 000 against FlamFlung Lt relating to defective 3D High definition LED televisions since the company was obliged to recall all such televisions sold to customers and refund the customers in full.

At year end, the legal advisors are of the opinion that it is probable but not virtually certain that the company will be successful with their claim.

## **PART B**

### **STATEMENT OF CHANGES IN EQUITY EXTRACT AS AT 31 MARCH 2012**

	<b>Retained Earnings</b>
	<b>R</b>
Balance at beginning of year	1490 000
Total Comprehensive Income for the year	1372 000
Dividends : Ordinary	(650 000)
Balance at end of year	<b>2212000</b>

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012**

#### **1. Events after the reporting period**

On 5 April 2012 the board of directors declared a preference dividend of 10c per share for the year ended 31 March 2012. The effect of the dividend is that it will reduce retained earnings by R10 000 (100 000 shares x 10c per share).

## OCTOBER / NOVEMBER 2012

### SOLUTION 1 : CONCEPTUAL FRAMEWORK , ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AN ERRORS, EVENTS AFTER THE REPORTING PERIOD, MINCOME TAXES, REVENUE AND PROVISIONS, CONTINGENT LIABILITIES A ND C ONTINGENT ASSETS

#### Question 1

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

This should only be recognized if:

- (a) It is probable that any future economic benefit associated with the item will flow to or from the entity and
- (b) The item has a cost or value that can be measured with reliability.

In this particular instance, it is not clear if the entity has control over the resource and it is difficult or unclear as to the measurement of the future expected economic benefits although the improve image might have an indirect effect on benefits. As such, this donation falls short of the definition of an asset and hence should not be capitalize.

#### 2. 4Feed Limited General Journal

	Debit	Credit
	R	R
Revenue (SCI)	60 000	
Income received in advance (SFP)		60 000
Inventory (60 000 x 100/120 ) (SFP)	50 000	
Cost of Sales (SCI)		50 000

## NOTES

Revenue should only be recognized when significant rights and rewards of ownership are transferred and when no continuing managerial involvement or effective control associated with ownership is maintained. The risks transfer on 10 July 2012, after year end, as such this sale should be recognized in the financial statements for the year ended 30 June 2013.

### 3. CALCULATION OF CORRECTED PROFIT BEFORE TAX FOR 4 FEED LIMITED FOR THE YEAR ENDED 30 JUNE 2012

	R
Provisional profit before tax	940 000
Income received in advance	(60 000)
Cost of sales on income received in advance	50 000
Depreciation on equipment (360 000 – 40 000/4)	(80 000)
Inventory – damaged	(210 000)
<b>Corrected profit before tax</b>	<b>639 500</b>

#### Question 4

### CALCULATION OF 4 FEE LIMITED'S CURRENT TAX DUE TO THE SA REVENUE SERVICE FOR THE YEAR ENDED 30 JUNE 2012

	R
Profit before tax (see 3)	639 500
Exempt Differences	(130 000)
Donations	110 000
Foreign income received from Zimbabwe	(240 000)
Temporary Differences	33250
Income received in advance	60 000
Depreciation	80 000
Tax allowance (500 000 ÷ 5)	(100 000)
Decrease in allowance for credit losses (account 40 000 – 31 000)	(9000)

Decrease in allowance for credit losses – tax (25% x 9000)	2250
Taxable income	<b>542 750</b>
Current tax at 28% (542 750 x 28%)	151970
Provisional tax payments (65 000 + 55 000)	(120 000)
<b>Amount due to SARS</b>	<b>31970</b>

### Question 5

#### CALCULATION OF DEFERRED TAX IN THE STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2012

	Carrying Amount	Tax Base	Temporary Difference	Deferred Tax Asset/ (Liability) at 28%
	R	R	R	R
Income received in advance	60 000	-	60 000	16 800
Manufacturing Equipment (360 000 – 40 000 – 80 000)	240 000			
(340 000 – 100 000 – 40 000)		200 000	40 000	(11 200)
Allowance for credit losses (31 000 x 25%)	31 000			
		7750	23250	6510
Deferred tax asset – 30 June 2012				<b>12110</b>

### Question 6

**4FEED LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2012**

	R
Income Tax Expense	
<b>Tax Rate Reconciliation</b>	
Standard tax rate [ 639 500 (3) x 28%	179 060
<b>Exempt Differences</b>	
Donations paid (110 000 x 28%)	30 800
Foreign income (240 000 x 28%) – 36 000	(31200)
	<b>178 660</b>

### Question 7

#### 4FEED LIMITED

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2012

##### 1. PROFIT BEFORE TAX

Included in depreciation for 2012 is a change in accounting estimate which resulted in an increase in the depreciation of R16 000 [ 80 000 – (360 000 – 40 000) x 20% ] arising from the pre – decision to change the method of the depreciation to the straight – line method from reducing balance method on the manufacturing equipment. The remaining useful life of the manufacturing equipment was taken to be 4 years. This Change will result in a decrease of depreciation in future periods of R16 000.

##### 2. Contingent Asset

4 Feed Limited repaired burst water pipes in the warehouse. The incident happened in June 2012. Due to the damage caused by the burst water pipes it is probable but not virtually certain, that the landlord of the warehouse will refund 4Feed Limited for the repair costs incurred.

##### 3. Contingent Liability

During January 2012, a claim of R500 000 was received from the Benfontein Horse Racing Club against the company after one of its champion race horses died during a horse race allegedly due to horse feed it ate which was produced by 4Feed Limited an initial test found traces of toxic substances in the specific batch of horse feed. A t year

end, the legal advisors of 4Feed Limited advised the company that it is not probable that 4Feed Limited will be found liable for the claim.

No provision and no disclosure should be made for the claim of R100 000 made by Mr. Kansvat on 20 January 2012 as the legal advisors of 4Feed Limited are of the opinion that the probability of the claim being successful is remote.

#### 4. Error

Correction in respect of repair costs incorrectly recorded in the general ledger as additions / improvements to the manufacturing equipment instead of the repair expense account.

The correction of the error has been accounted for retrospectively and comparative amounts have been appropriately restated including the correction on the opening balance of retained earnings at the beginning of 2012.

	<b>R</b>
Increase in expenses	35088
Decreased in current tax expense (35 088 x28%)	(9825)
Decrease in profit	<b>25 263</b>
	40 000
Decrease in manufacturing equipment account	4912
Increase in VAT input account	35 088
Decrease in current tax liability (35 088 x 28%0	(9825)
Decrease in equity	<b>25 263</b>

## SOLUTION 2

### ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS, EVENTS AFTER THE REPORTING PERIOD, INCOME TAXES, REVENUE, PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS AND FAIR VALUE MEASUREMENT

#### PART A

1. Revenue from the rendering of services should be recognized after satisfying the following:
  - (a) It is probable that future economic benefits will flow to the entity:
  - (b) The revenue can be measured reliably.
  - (c) In accordance to the stage of completion which should be measurable at the end of the reporting period.
  - (d) The related costs can be measured reliably.

If the outcome, of a transaction pertaining to the rendering of services cannot be estimated reliably then the revenue should only be recognized to the extent of the recoverable.

#### 2. DATACAPS LIMITED GENERAL JOURNAL –

2010		DEBIT	CREDIT
		R	R
Dec 31	Provision for data recovery costs (SFP)	230 000	
	Bank (SFP)		230 000
2011			
Jan 31	Provision for data recovery costs (SFP)	127 000	
	Bank (SFP)		127 000
2011			
Mar1	Off – site back up costs (SCI)	400 000	
	Bank (SFP)		400 000
2012			
Feb 29	Provision for data recovery costs (SFP)	328 000	



	(685 000 – 230 000 – 127 000)		
	Bank (SFP)		328 000
	Data recovery costs (SC1)		
	(328 000 – 305 000)		23 000
<b>Feb 29</b>	Licence fees paid in advance (SFP)		
	(60 000 X (2 X 12-2) / 2)	55 000	
	Licence fees paid (SCI)		55 000
<b>Feb 29</b>	Service fees received (SCI)	1000	
	50 000 X 2%		
	Allowance for settlement		
	Discounts granted (SFP)		1000

## NOTE

The licence fees were paid for a period of two years in January 2012 and the year end is February 2012. The licence fees expenses to be recognized is only for two months (January to February 2012) and the remainder has to be treated as an advance payment which would be recognized in the relevant periods.

### Question 3

#### DATA CARDS LIMITED

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENED 29 FEBRUARY 2012

##### 3.1. PROVISIONAL FOR DATA RECOVERY COSTS

	2012	2011
	R	R
Carrying amount at beginning ,of year	328 000	-
Provision created for the year		685 000
Provision used during year (2011 (230 000 + 127 000)	(305 000)	(357 000)
Unused provision received (328 000 – 305 000)	23 000	
	-	<b>328 000</b>

On 31 October 2010 Datacaps Limited's computer data warehouse was completely destroyed by a fire caused by arson. As a result, data of a client was completely destroyed in the fire after which Datacaps assured the client that the data will be recovered at no additional costs to the client. The estimated costs totaling R662 000 (R230 000 + R127 000 + R305 000) have already been incurred and at year end it is expected that no further costs will be incurred.

### 3.2. Change in Accounting Policy

- After the review of the raft financial statements, the financial director decided to change the current inventory.
- Valuation method to the first – in , first – out method from the last – in, first out method in order to improve the matching of revenue and expenses to ensure a more fair presentation of the financial position of the company.
- The change has only been accounted for retrospectively from the beginning of 2012 since the value of inventory according to the first – in , first – out method on 28 February 2010 could not be determined as some of Datacaps Limited data was destroyed in a fire. The effect of the change is as follows:

	2012	2011
	R	R
Decrease in cost of sales (12 000 – 20 000)	100 000	
Increase in income tax expense (100 000 x 28%)	(28 000)	
	<b>72 000</b>	
Increase in inventory	120 000	20 000
Increase in deferred tax liability (20 000 x 28%)		(5600)
Increase in incurrent tax liability (120 000 x 28%)	(33600)	
	<b>86400</b>	<b>14400</b>
Adjustment to retained earnings at the beginning of 2012		<b>14 400</b>

### 3.3. Event after the reporting Period

On 31 March 2012 ASBA Limited downgrades all credit ratings for companies in the IT Industry. The announcement by ASBA Limited resulted in significant decline in the share price of Datacaps Limited from R2 per share to 50c per share and it is furthermore expected that

Datacaps will experience a significant decline in profits in future due to the negative market sentiment towards the IT Industry after the announcement.

#### 4. DATA CAPS LIMITED

#### CALCULATION OF DEFERRED TAX IN THE STATEMENT OF FINANCIAL POSITION AS AT FEBRUARY

	Carrying Amount	Tax Base	Temporary Difference	Deferred Tax Asset / Liability at 28%
2011	R	R	R	R
Provision for data recovery costs	328 000	-	328 000	91840
Inventory	195 000	175 000	20 000	(5600)
Deferred Tax Asset				<b>86240</b>
<b>2012</b>				
Expenses prepaid	55 000	-	55 000	(15400)
Allowance for settlement				
Discounts granted	1000	-	1000	280
				<b>(15120)</b>

NB: The question has not given SARS' treatment of allowance for settlement discounts granted; as such we have assumed that this is not recognized by SARS. If we assume that SARS recognizes the allowance, then there would be no deferred tax on the allowance.

For tax purposes an expense is not deductible for tax purposes until the expense is actually paid or incurred. In terms of S23(e) of the Income Tax Act a taxable income if this deduction originate from as reserve transfer or any other capitalization of income (raising a provision).

The tax base of the provision is the carrying amount less the amount that will be deductible for tax purposes in future. Due to the deductibility of actual expenses incurred, the tax base will be nil because the claim will only be deductible for tax purposes when it is settled.

## **PART B**

Market participants are buyers and sellers in the principal or most advantageous) market for the respective asset or liability and these should have all of the following characteristics:

- (i) Independence: the participants must be independent of each other, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
- (ii) Knowledgeable: the participants should have a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual, normal, or customary.
- (iii) The participants should be able to enter into a transaction for the asset or liability ;  
and
- (iv) The participants should be willing to enter into a transaction for the asset or liability, i.e. they are motivated but not forced or otherwise compelled to do so.

## MAY / JUNE 2013

### SOLUTION 1

#### CONCEPTUAL FRAMEWORK, PRESENTATION OF FINANCIAL STATEMENTS, ACCOUNTING ESTIMATES AND ERRORS. EVENTS AFTER THE REPORTING PERIOD INCOME TAXES AND PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS.

##### 1. (a) Repair Costs – expense

Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants (par. 4.25 (b) ).

##### (b) Provision for manufacturing defects – Liability

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (par 4.4 (b)).

##### 2. Eprint Limited

Calculation of the current tax due to SA Revenue service for the year ended 31 March 2013

	<b>R</b>
Provisional profit	1144 000
Exempt Differences	(137 075)
Penalty (2240 x 100/28)	8000
Foreign income)	(120 000)
Capital profit on sale of machine (49 5075 – 420 000)x (100 – 66.6%)	(25075)
<b>Temporary Differences</b>	<b>(7300)</b>
Depreciation (63 000 +29 200)	92 200
Tax allowance [420 000 ÷ 4) + (584 000 ÷ 4)]	(251 000)
Provision for manufacturing defects (43500 – 6500)	37 000
Profit on sale of machinery [ 159 075 – (495075 – 420 000)]	(84 000)
Recoupment on sale of machinery [ 420 000 – (420 000 / 4 x 2	210 000

Repair costs	(29500)
<b>Change in accounting policy accounting</b>	<b>18000</b>
Taxable income	<b>999625</b>
Current tax at 28% (999625 x 28%)	279 895
Provisional tax payments (28 000 + 22 000)	(50 000)
Amount due to the SA Revenue Service	<b>229 895</b>

### 3. Eprint Limited

#### CALCULATION OF THE DEFERRED TAX BALANCE IN THE STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2013

	Carrying Amount	Tax Base	Temporary Difference	Deferred Tax at 28% Asset / (Liability)
	R	R	R	R
Machinery	554 800 <sup>(1)</sup>	438 000	116 800	(32 704)
Provision for machinery defects	43500	-	43500	12180
Inventory	230 000	290 000	60 000	16800
Deferred tax liability				<b>(3724)</b>

(i)  $584\,000 - 29200 = 554\,800$

(ii)  $584\,000 - (584\,000/4) = 438\,000$

### 4. Eprint Limited

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2013

Income tax expenses

Major components of tax expense:

	2013
	R
Current tax expense – current year (see 2)	279 895
Deferred (movement) tax expense – current (3724 – 1680)	2044
Foreign tax	240 00
	<b>305 939</b>

### Question 5

#### E. PRINT LIMITED

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2013

##### 1. PROVISION FOR MANUFACTURING DEFECTS

	2013	2012
	R	R
Carrying amount at beginning of year	36 000	-
Provision created for the year	43 500	36 000
Provision used during the year	(29 500)	-
Unused provision reversed (36 000 – 29 500)	(6500)	
Carrying amount at end of year	<b>435 00</b>	<b>36 000</b>

During February 2012, E print Limited implemented a guarantee policy to repair all electronic books with a manufacturing defect at no cost to the customer, within 6 months from data of sale.

##### 2. Events after the reporting period

On 15 April 2013, Eprint Ltd became aware that kids' books Limited, a significant customer was currently experiencing serious financial and cash flow problems after their national warehouse, which was not insured, was destroyed by a fire on 9 April 2013. There is uncertainty if kids

Books Limited will be able to settle the outstanding debt, due to Eprint Limited which totals R130 130.

## QUESTION 6

### Eprint Limited

Extract from the statement of changes in equity for the year ended 31 March 2013

	<b>Retained</b>
	<b>Earnings</b>
	<b>R</b>
Balance at 1 April 2011 (1827760 + 12 240)	1840 000
Change in accounting policy	(12240)
Restated balance	1827760
<b>Changes in equity for 2012</b>	
Total comprehensive income for the year (Restated)	650 000
Balance at 31 March 2012	2477760
<b>Changes in equity for 2013</b>	
Total comprehensive income for the year (1144000 – 305 959)	838061
Balance at 31 March 2013	<b>3315821</b>

## Question 7

### Eprint Limited

EXTRACT OF THE STATEMENT OF FINHANCIAL POSIOTION AS AT 31 MARCH 2013

	<b>2013</b>	<b>2012</b>
	<b>R</b>	<b>R</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Inventory	230 000	103 000

## SOLUTION 2:

**ACCOUNTING POLICIES, CHANGS, ACCOUNTING ESTIMATES AND ERRORS, INCOME TAXES, REVENUE, PROVISIONS, CONTINGENT LIABILITIES AN CONTINGENT ASSETS AND FAIR VALUE MEASUREMENTS**



1. Bill and hold sales are recognize when buyer takes title and it is probable that delivery will be made.

The item subject of delivery should be on hand, identified and read for delivery to the buyer at the time the sale is recognized. The buyer should specifically acknowledge the deferred delivery instructions and the usual payment terms should apply.

## 2. CARNASTIE LIMITED GENERAL JOURNAL

	Debit	Credit
	R	R
Bank	620 730	
Membership fees / revenue (85 +14) + (5700 x 1.1.)		620 730
Bank (1330 x 513)	682290	
Revenue 9682290 – 6156		676 134
Deferred income (12 x 513)		6156
Revenue (48 500 + 80 000)	128 500	
Trade payables		128 500
Depreciation	117188	
Accumulated Depreciation [1406250/3 – (1406 250 – 1054 688) ]		117 188
Bank	400 000	
Revenue		400 000
Cost of sales (400 000 x 100/125)	320 000	
Inventory		320 000

NB: The bill an hold sale should be recognized as a sale during the current financial period because , it is probable that delivery will be made and all other conditions are met as specified

in part (1) of this question since Caddyshack took title and accepted billing of the goods which are currently in stock.

### 3. CARNASTIE LIMITED

#### Calculation of deferred tax balance for the year ended 28 February 2013

	Carrying Amount	Tax Base	Temporary Difference	Deferred Tax at 28% (Asset / Liability)
	R	R	R	R
Deferred income	6156	-	6156	1724
Machinery	937 500 <sup>1</sup>	1000 000 <sup>2</sup>	62500	17500
Deferred tax asset				<b>19224</b>

1.  $[1406\ 250 - (1\ 406\ 250 \div 3)] =$

2.  $[2500\ 000 - (2500\ 000 \div 5) \times 3] =$

### CARNASTIE LIMITED

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 2013

##### 1. Profit before tax

Included in depreciation for 2013 is a change in accounting estimate which resulted in an increase in depreciation of R117188  $[(1406250 - 1054688)]$  arising from the decision to change the method of providing for depreciation from the reducing balance to the straight line method on the tractor. The remaining useful life of the tractor was taken to be 3 years. This change will result in a decrease of depreciation in future periods of R117 188.

##### 2. Error

Correction in respect of credit notes incorrectly debited to the trade payable account. The effect of the correction on the opening balance of retained earnings at the beginning

of 2013 was adjusted while the comparative amounts were rested accordingly. The correction was done retrospectively.

	<b>2013</b>	<b>2012</b>
	<b>R</b>	<b>R</b>
Decrease in revenue (190 000 + 260 000) (48 500 + 80 000)	128 500	450 000
Decrease in current tax expense (450 000 x 28%) (28 500 x 28%)	(35 980)	(126 000)
	<b>92520</b>	<b>324 000</b>
Increase in trade payables	128 500	450 000
Decrease in current tax liability	(35980)	(126 000)
Adjustment to retained earnings at beginning of year 2013	<b>92520</b>	<b>324 000</b>

### 3. Contingent Liability

On 12 February 2013, a claim of R3 500 000 was instituted by Geen Peace against Carnastie Limited after environmental damage caused to a wetland adjacent to the company's Golf course allegedly caused by fertilizer used by the company on their greens which allegedly polluted the environmentally sensitive wetland. At the year end, the legal advisors of Carnastie Limited advised the company that they were of the opinion that it is not probable that the claim will be successful.

### 4. Contingent Asset

Carnastie Limited instituted a claim of 340 000 against Fallaway Golf on 31 January 2013 relating to a patent infringement for the illegal copying of the Bling brand's technology. The legal advisor has advised that there is sufficient evidence against Fallaway Golf to prove the infringement and it is therefore, probable but not virtually certain that the claim will be successful.

## PART B

1. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.

2. The transaction price and the fair value of an asset might differ on the initial recognition of an asset due to the following:
  - (a) The transaction is between related parties:
  - (b) The transaction takes place under duress or the seller is forced to accept the price in the transaction;
  - (c) The unit at account represented by the transaction price is different from the unit of account for the asset measured at fair value.
  - (d) The market in which the transaction takes place is different from the principal market (or most advantageous market).

## OCTOBER / NOVEMBER 2013

### SOLUTION 1

1. CONCEPTUAL FRAMEWORK , ACCOUNTING ,POLICIES , CHANGES IN ACCOUNTING ESTIMATES AND ERRORS, INCOME TAXES, REVENUE PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS ANS FAIR VALUE MEASUREMENT.

### LAWNERS LIMITED

### GENERAL JOURNAL

	Debit	Credit
	R	R
Dividends expense (SOCIE) (500 000 X 10C)	50 000	
Dividend payable (SFP) (50 000 – 750)	42 500	
SARS – dividends tax payable (SFP) (50 000 X 15%)		7 500

2. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

In this case, there is a present obligation as the company has declared the dividend and will pay the dividend refers to the investment made by the partners entitling them to the dividend and the declaration of the dividend which has taken place. The liability for dividends tax also has to be paid at the end of the month following the month in which the dividend was paid or became payable to the beneficial owner. The declared dividend will result in an outflow of resources from the entity on the date that the dividend will be paid out and next month (July) 2013) when the company is required to pay the withholding tax.

Since this dividend declared meets the entire criterion for classifying under the liabilities.

**3. LAWNERS LIMITED  
GENERAL JOURNAL**

	Debit	Credit
	R	R
Retained earnings (beginning of year): (81000 + 54 000)	135 000	
Deferred income (loyalty award credits (SFP))		135 000
Revenue (P/L)	115 400	
Deferred income (SFP)		115 400

**4. LAWNERS LIMITED  
CALCULATION OF THE CORRECTED PROFIT BEFORE TAX IN THE STATEMENT  
MOF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE EYAR  
ENDED 30 JUNE 2013**

	R
Provisional profit before tax	1150 000
Deferred income – loyalty award credits	(115 400)
Depreciation : Manufacturing Equipment (excluding spray painting equipment [(1868 800 – 480 000) ÷ 2 – (1868 800 – 480 000) x 20%	(416 640)
<b>Corrected profit before tax</b>	<b>617 960</b>

**Solution 2**

**ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS,  
EVENTS AFTER THE REPORTING PERIOD, INCOME TAXES, REVENUE AND THE  
REPORTING PERIOD, INCOME TAXES, REVENUE AND PROVISIONS , C ONTINGENT  
LIABILITIES AN C ONTINGENT ASSETS**

**1. BOXTER LIMITED**  
**GENERAL JOURNAL**

	Debit	Credit
	R	R
Accrued Income (1385 x 2155 x 20%) (SFP)	596 935	
Commission Earned (P/L)		596 935
Credit losses (P/L)	17 500	
Provision for credit losses (SFP)		17 500
Bank (SFP)	750 000	
Revenue (P/L) [750 000 – 43125]	706 875	
Income Prepaid (SFP) 45 000 X 23/24		43 125
Cost of sales (P/L) [750 000X 100/125]	600 000	
Inventory (SFP)		600 000

The above journal entry assumes that the mark up is added on the total cost including the maintenance plan. If it is assumed that the mark – up is added on the cost excluding the maintenance plan, the last journal entry will be as follows;

Cost of sales (P/L) [ 750 000 – 45 000) X 100/125	564 000	
Inventory (SFP)		564 000

**2. BOXTER LIMITED**  
**CALCULATION, OF DEFERRED TAX IN THE STATEMENT OF FINANCIAL POSITION FOR**  
**THE YEAR ENDED 28 FEBRUARY 2013**

	Carrying amount	Tax Base	Temporary Difference	Deferred Tax Asset (Liability) at 28%
	R	R	R	R
Inventory	683 000	486 000	197 000	(55160)
Provision for credit losses	17500	-	17500	4900
Income received in advance	43125	-	43125	12075
Provision for warranty costs	307 000	-	307 000	85960
Deferred tax asset				<b>47775</b>

### 3. BOXER LIMITED

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 2013

##### 1. Change in Accounting Policy

After a review of the draft financial statements, the financial director decided that the current inventory valuation method should be changed to the first – in, first – out method from the last – in, first out method to ensure that more appropriate estimates of the value of inventory is ascertained. This change in accounting policy has already been recorded in the accounting records retrospectively. The effect of the change for 2013 is as follows;

	2013	2012
	R	R
Decrease in cost of sales (829 500 – 787 500) (780 000 – 750 000)	42 000	30 000
Increase in income tax expense at 28%	(11760)	(8400)
	<b>30240</b>	<b>21600</b>
Increase in inventory (683 000 – 486 000) (510 000 – 355 000)	197 000	155 000
Increase in deferred tax liability (155 000 x 28%) 9197 000 x 28%)	(55160)	(43400)
	<b>141 840</b>	<b>111600</b>
Adjustment to retained earnings at the beginning		<b>111 600</b>



## 2. Provision for warranty costs

	2013	2012
	R	R
Carrying amount at beginning of year	212 000	
Provision used during year	(100 911)	
Unused provision reversed(212 000 – 100911)	(111089)	
<b>Provison created for the year</b>	<b>307 000</b>	<b>212 000</b>
<b>Carrying amount at end of year</b>	<b>307 000</b>	<b>212 000</b>

Provision has been made for warranty costs to repair defective vehicle tracking systems returned by customers under a two year mechanical warranty.

Based on past experience it is estimated that 12% of the vehicles tracking systems sold are returned with defects that has to be repaired.

## 3. Provision for onerous contract

	2013	2014
	R	R
Carrying amount at beginning of year	-	-
Provision created for the year		
950% x 30 000 x 6)	90 000	-
Carrying amount at end of year	<b>90 000</b>	-

Provision has been made for lease expenses resulting from onerous contract. Boxter Limited rebooted its manufacturing plant in Port Elizabeth to Cape Town.

The current lease agreement would result in a penalty of 50% of the remaining lease payments due, payable in cash within three months after termination of the agreement. The remaining period up to contractual agreement data is six months (March to August).

## 4. Events after the reporting period

On March 31, the eastern side of the Cape Town manufacturing plant was destroyed in a fire, caused by the defective installation of electrical wiring during the relocation. The damage involved was estimated at R500 997, within R10 997 relating to damaged inventory. The company's insurance policy does not cover this contingency and the claim was repudiated by the insurance company. A contract has been concluded with VolksWerkers Limited to repair the damaged manufacturing plant at a cost of R500 000.

## 5. Contingent Liability

A contract was concluded to repair a manufacturing plant with VolksWerkers at a cost of R500 000. Refer to note 4.

## 5. LAWNERS LIMITED

### CALCULATION OF CURRENT TAX EXPENSE FOR THE YEAR ENDED 30 JUNE 2013

	R
Profit before tax (see 4)	617 960
Exempt differences	64 980
Capital profit on sale of spray painting equipment (780 000 – 750 000 ) x (100 – 66.6%)	(10 020)
Depreciation – administration buildings	75 000
<b>Temporary differences</b>	<b>164800</b>
Depreciation – manufacturing buildings	100 000
Depreciation - manufacturing equipment [301760 + 416640 (see 4)]	718 400
Deferred income – loyalty award credits	115 400
Profit on sale of spray painting equipment [750 000 – (480 000 – 24 000)]	(294 000)
Recoupment on sale of spray painting Equipment [750 000 – (450 000 – 150 000)]	450 000
Tax allowance – manufacturing building	(125 000)
Tax allowance – manufacturing equipment	(800 000)
Taxable profit	847740
Temporary difference – Tax loss carried forward from previous year	(95000)
Taxable profit for the year	<b>752740</b>
<b>Current tax at 28% (752740 x 28%)</b>	<b>210 767</b>

## 6. LAWNERS LIMITED

### CALCULATION OF DEFERRED TAX IN THE STATEMENT OF FINANCIAL POSITION FOR THE YEAR ENDED 30 JUNE 2013

	Carrying Amount	Tax Base	Temporary Difference	Deferred Asset (liability ) at 28%
	R	R	R	R
Deferred income (115400 +81000 + 54 000)		-	250 400	70 112
Manufacturing building		18750002	125 000	(35 000)
Manufacturing equipment	694 4003	10 00004	594 400	(166 432)
				<b>(131320)</b>

1.  $2100\ 000 - 100\ 000 = 2000\ 000$
2.  $2000\ 000 - 125\ 000 = 1875\ 000$
3.  $[(1868800 - 480\ 000) \div 2] = 694400$
4.  $(1200\ 000 - 450\ 000) - (800\ 000 - 150\ 000) = 100\ 000$

## 7. LAWNERS LIMITED

### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2013

#### 1. Profit before tax

Included in depreciation for 2013 is a change in accounting estimate which resulted in an increase in depreciation of R416 640  $[(1868800 - 480\ 000) \div 2 - (301760 - 24000)]$  arising from the decision to change the method of depreciation to the straight line method over 2years from the reducing balance method on the manufacturing equipment. The remaining useful life of the manufacturing equipment was taken to be 2years. This change will result in a decrease of depreciation in future periods at R416 640).

#### 2. Error

Correction in respect of revenue attributable to loyalty award credits which was incorrectly recorded by including this revenue immediately on delivery of goods sold since 2011 financial year. The effect of the correction on the opening balance of retaining earnings at the beginning of 2012 was adjusted while the comparative amounts were restated accordingly. The effect of the correction is as follows;

	2013	2012	2011
	R	R	R
Decrease in revenue	(115400)	(81000)	(54 000)
Decrease in taxation expense at 28%	32312	22680	15 120
Decrease in profit	83088	58320	38880
Increase in deferred income	115400	81000	54 000
Decrease in current taxation liability	(32312)	(22680)	(15120)
Decrease in equity	<b>83088</b>	<b>58320</b>	<b>38880</b>
Adjustment to retained earnings			
At beginning of year			<b>38880</b>
(58 320 – 38 880)		<b>97 200</b>	

### 3. Contingent Liability

On 21 April 2013, a claim of R850 000 was instituted by Lazee Limited against Lawners Limited for defective lawnmower tractors sold to Lazee Limited which allegedly resulted in a lawnmower tractor's brakes failing causing injury to two of Lazee Limited's holidaymakers. The company's legal advisors are of the opinion that it is probable, but not virtually certain, that Lawners Limited will not be found liable for the claim.

### 4. Contingent Asset

On 31 May 2013, Lawners Limited instituted a legal claim of R250 000 against a newspaper as a result of the negative publicity received by the company due to a headline news item that appeared in the paper adversely describing the quality of the lawnmower products manufactured and sold by lawners Limited. The article was titled "Lawnmower tractor injures holidaymakers" resulted from injuries to two journalists of the paper on holiday allegedly caused by a failure in the brakes of a lawnmower tractor sold by Lawnmowers Limited to Lazee Limited.

At year end, the legal advisors of the company are of the opinion that it is probable but not virtually certain, that lawners Limited will be successful with their claim.

8. The three most widely used valuation techniques that can be used to determine the fair value of the buildings according to IFRS13 – Fair value measurement are :
  - (a) The market approach
  - (b) The cost approach
  - (c) The income approach
  
9. The following three factors should be considered in determining the highest and best use of the buildings according to IFRS 2013 – fairvalue measurement.
  - (a) A use that is physically possible. (e.g.) the location or size of the property.
  - (b) A use that is legally permissible : this takes into account any legal restrictions on the use of the asset.
  - (c) A use that is financially feasible: takes into account whether or not it generates adequate income or cash flows.

**MAY / JUNE 2014**

**SOLUTION 1**

**1. CONCEPTIONAL FRAMEWORK FOR FINANCIAL REPORTING 2010, ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS , PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS AND INCOME TAXES.**

(a) Expense – Claim

An expense is recognized when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the statement of financial position as a asset. The claim will not produce no future economic benefits. This claim will result in a decrease in economic benefits; therefore it qualifies to be recognized as an expense.

(b) Provision for claim – liability

A liability is a present – obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

This should be raised as the legal advisors have advised that judgment will probably be in favor of Designer Kitchen Ltd. This result from past events (duplication of kitchen cupboard designs) and the amount involved can be estimated). As such a liability should be recognized.

**2. KITCHEN SUPPLY LTD**

**CALCULATION OF CORRECTED PROFIT BEFORE TAX IN THE STATEMENT OF PROFIT OR LOSS AN OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRAURY 2014**

	<b>R</b>
Provisional profit	960 000
Depreciation Delivery vehicles (25% x 750 000 – (20% x 750 000) repairs	(37500)
Depreciation: Administration building (180 000 x 5%)	(9000)
<b>Corrected profit before tax</b>	<b>913 500</b>

### 3. KITCHEN SUPPLY LTD

#### CALCULATION OF CURRENT TAX DUE TO THE SA REVENUE SERVICE FOR THE EYAR ENDED 28 FEBRUARY 2014

	<b>R</b>
Profit before tax (see 2 above)	913 500
Exempt Differences	10 660
Capital profit on sale at machinery (150 000 – 140 000) x (100% - 66.6%)	(3340)
Foreign income receive from the United Kingdom	(20 000)
Legal fees 15 000 x (100% - 40)	9000
Fines paid to department of Trade and industry	25 000
Temporary differences	98 000
Profit on sale of machine (140 000 – 84 000)	(56 000)
Recoupment on sale of machine (140 000 – 70 000)	70 000
Depreciation (470 000 + 375 000 + 9000)	516500
Claims	90 000
Income received in advance	40 000
Insurance premium – accounting (110 000 + 50 000 – 80 000)	80 000
Insurance – SARS	(110 000)
Tax allowance. Delivery vehicles (375000 – 87500)	(187 500)
Tax allowance – machinery (825 000 – 460 000)	(345 000)
<b>Taxable income</b>	<b>1002160</b>
Current tax (1022160 x 28%)	
Provisional tax payments (60 000 + 50 000)	(110 000)
<b>Amount due to SARS</b>	<b>176205</b>

### 4. KITCHEN SUPPLY LTD

#### CALCULATION OF DEFERRED TAX BALANCE IN THE STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 2014

	Carrying Amount	Tax base	Temporary Difference	Deferred Tax Asset / (liability) at 28%
	R	R	R	R
Income received in advance	40 000	-	40 000	11200
Prepaid expenses : insurance	80 000	-	80 000	(22400)
Provision for claim	90 000	-	90 000	25 200
Delivery vehicles	26 2500	187500	75 000	(21 000)
Machinery	576 000	480 000	96 000	(26 880)
Deferred tax liability				<b>(33 880)</b>

(i) Delivery vehicles carrying amount = 300 000 – 375 00 = 262 500

## 5. KITCHEN SUPPLY LTD

TAX RATE RECONCILIATION	R
Standard tax (913 500 x 28%)	255780
exempt Differences	
Capital profit on sale of machine (3340 x 28%)	(935)
Foreign income (20 000 x 28%) – 5000)	(600)
Legal fees (9000 x 28%)	2520
Fines (25 000 x 28%)	7000
	<b>263765</b>

## 6. KITCHEN SUPPLY

### NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 2014

#### 1. Profit before tax

Included in depreciation for 2014 is a change in accounting estimate which resulted in an increase depreciation of R37 500 on the vehicles arising from the decision to change the



method of depreciation to 25% per annum, according to the straight – line method from 20% per annum straight – line method.

The remaining useful life of the asset was taken to be shorter than originally estimated. This change will result in a decrease of depreciation in future periods of R37 500.

## 2. Contingent liability

On 15 January 2014, a claim of R50 000 was instituted by a customer against Kitchen Supply Ltd for claimed sub – standard installation. The legal advisors were of the opinion that it is not probable that Kitchen Supply Lt will be found liable for the claim, as the installation met all the quality control specifications at the time of the installation.

## 3. Error

Correction in respect of air conditioners purchased and installed in the administration building but incorrectly expensed as repairs in the statement of profit or loss and other comprehensive income. The effect of the correction on the opening balance of retained earnings at the beginning of 2013 was adjusted while the comparative amounts were restated accordingly. The effect of the correction is as follows;

	2014	2013
	R	R
Decrease in repairs		180 000
Increase in depreciation (180 000 x 5%)	(9000)	(9000)
Decrease in taxation expense (9000 x 28%)	2520	
Increase in taxation expense		(47880)
	<b>(6480)</b>	<b>123120</b>
Increase in Administration building (180 000 – 9000)	62000	171000
Increase in current tax due	(45360)	(47 8800)
	<b>116640</b>	<b>123120</b>

Adjustment to retained earnings

At beginning of year 2013

123 120

## SOLUTION 2

### ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS, EVENTS AFTER THE REPORTING PERIOD, REVENUE, PROVISIONS, CONTINGENT LIABILITES AN CONTINGENT ASSETS AND FAIR VALUE MEASUREMENT

#### 1. SQUAD CARS LTD

##### GENERAL JOURNAL

Repair (P/L)	45000	
Revenue (P/L)		45 000
Bank (SFP)	15 000	
Debtor/ Mr Surprise (SF)	3000	
Revenue		18 000
Cost of sales (18 000 x 30/100) P/c	12 600	
Inventory SFP		12 600
Employee benefits 91.5% x 320 000) (P/L)	4800	
Expenses accrued (SFP)		4800
Repair costs (P/L) (600 000 X 35%) + (1000 000) X 5%	260 000	
Provision for warrants (SFP)		260 000
Repair costs (P/L) (600 000 X 35%) + (1000 000) X 5%	156 000	
Provision for warranty (SFP)		156 000
Debtors / (60 % x 260 000)		
Repairs		

#### 2. CONTINGENT ASSET

The supplier of battery operated go – karts undertakes to recoup 60% of the repair costs incurred by Squard car Ltd from the supplier for free repairs to detective g – karts, returned within the three month guarantee period by Squad Cars' customers. This recoupment will be subject to inspection by supplier to determine the causes of the repairs. It is probable but not virtually certain that R156 000 will be recouped from the supplier by the year – end.

### 3. SQUAD CARS LIMITED

#### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 28 FEBRUARY 2014

##### 1. Provision for Severance Package

	2014	2013
	R	R
Carrying amount at beginning of year	180 000	-
Provision used during year (130 000 + 40 000)	(170 000)	-
Unused provision reversed (180 000 – 170 000)	(10 000)	-
Provision created for the year	-	180 000
Carrying amount at end of year	-	<b>180 000</b>

In January 2013, a provision for the severance package of the just resigned managing director to be paid out. Although this was expected to be paid out by July 2013, the payments were only made in July and November 2013 due to a dispute on the severance packages.

##### 2. Change in Accounting

After the financial year the company directors decided at a board meeting that the current inventory valuation method should be changed to the first – in , first – out method from the last – in, first – out method in order to comply with the international Financial Reporting Standards and to give a more reliable value of inventory on hand. This change in reliable value of inventory on hand. This change in accounting policy was retrospectively accounted for all the years from 2013 to current year.

As a result, the change has been accounted for retrospectively. The effect of the change for the years is as follows.

	<b>2014</b>	<b>2013</b>	
Increase in cost of sales(8000 – 6000) (11000 – 8000)	(2000)	(3000)	
Decrease in income tax expense	560	840	
	<b>(1440)</b>	<b>(2160)</b>	
Increase in inventory	6000	8000	
Increase in current tax due	(1680)		
Increase in deferred tax liability 28%		(2240)	
	<b>4320</b>	<b>5760</b>	<b>7920</b>
Adjustment to retained earnings at beginning of year 2013			7920

### **3. Events after the Reporting Period**

On the 10<sup>th</sup> of April 2014, Squad Cars Ltd successfully obtained a second mortgage of R320 000 secured against land and buildings from CAT Bank at an interest rate of 10% per annum. The loan will finance the expansion of the trading premises.

4. Fair value refers to the price that would be received to sell an asset in an orderly transaction between market participants at the measurement data.

the following are the characteristics of an asset that should be taken into account when determining the fair value of an asset according to IFRS 13 – fair value measurement.

- (a) The condition and location of the asset;
- (b) Any restrictions on the sale or use of the asset;