Tutorial Letter 102/3/2014

Distinctive Financial Reporting

FAC3702

Semesters 1 and 2

Department of Financial Accounting

This tutorial letter contains additional questions with suggested solutions.

IMPORTANT INFORMATION:

Please activate your *myUnisa* and *myLife* email addresses and ensure you have regular access to the *myUnisa* module site FAC3702 as well as your group site.

Note: This is an online module, and therefore your module is available on *myUnisa.* However, in order to support you in your learning process, you will receive some study material in printed format.

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1 INTRODUCTION

Dear Student,

Attached please find questions with the suggested solutions. We suggest that you do these questions under exam conditions. Once you have completed the questions, you should then compare your answer to the suggested solutions. **Your answers to these questions must not be submitted to Unisa.** These questions will help you to identify areas of weaknesses that you must pay attention to.

Please note that these questions are <u>not of a similar standard as the exam questions, as the questions are not fully integrated</u>.

You will notice in our suggested solutions, dealing with company financial statements, opposite certain items calculations are shown in brackets. Such calculations are given for tuition purposes only and consequently do not form part of the statutory disclosure requirements.

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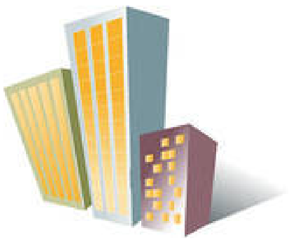

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3 ADDITIONAL QUESTIONS

QUESTION No.	SUBJECT	MARKS	TIME (Minutes)
1	IAS 16 - Property, plant and equipment	50	60
2	IAS 16 - Property, plant and equipment and IAS 40 - Investment properties	35	42
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7	IAS 21, 32, 39 - Effects of changes in foreign exchange rates and financial instruments	34	41
8	IFRS 5 - Discontinued operations	45	54
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QUESTION 1 (50 marks) (60 minutes)

The following information regarding the assets of DEL Ltd is presented to you.

1. Truck

DEL Ltd owns a truck (horse) with a trailer for long-distance transport of goods between Johannesburg and Cape Town. It was bought new on 1 April 20.7 and the following material parts with their respective useful lives were identified on that date:

Asset item	Cost price R	Residual value R	Estimated useful life
Horse	180 000	30 000	5 years
Engine	200 000	20 000	250 000 km
Trailer	150 000	25 000	5 years
Tyres (10 on horse, 16 on trailer)	104 000	-	40 000 km

The following is information regarding the asset items for the year ended 31 December 20.7:

Engine

The engine must undergo a major inspection and service every 50 000 km to maintain a useful life of 250 000 km. At the purchase date the cost was estimated at R22 000. On 1 December 20.7 the engine had 50 000 km on the clock and the cost of the service was R22 000.

Tyres

On 31 July 20.7, when the odometer reading was 25 000 km, a trailer tyre burst and was replaced for R4 200. On 31 October 20.7 when the odometer reading was 40 000 km, all the trailer tyres were replaced for R4 300 each, except for the replaced tyre which will only be replaced in 25 000 km's time. However, the tyres of the horse did not wear that quickly and an estimation showed that they will have a safe running surface for another 20 000 km. The odometer reading on the truck at year-end was 55 000 km.

2. Property

DEL Ltd owns erf 7 in Isando with a building there-on that serves as an office for its transport business. The following information relates to the property:

Asset	Purchase date	Cost R	Residual value R	Useful life
Land, erf 7, Isando	30 September 20.6	1 700 000	-	-
Building there-on	30 September 20.6	1 200 000	300 000	30 years

QUESTION 1 (continued)

Due to the popular situation of the property, the board of directors decided during 20.7 to disclose it at market value in the financial statements. It was revalued for the first time on 31 December 20.7 and will be revalued every two years thereafter. XY Valuers, sworn appraisers that have the necessary qualifications and experience to value similar property, valued the net replacement value of the land at R1 950 000 and the building at R1 370 000, with reference to active market prices. The market value of a similar thirty-year old building on 31 December 20.7 is estimated at R317 750. It is the policy of DEL Ltd to realise the revaluation surplus over the useful life of the underlying asset.

3. **Profit before tax** for the period including all the above mentioned information amounted to R700 000. Assume that all amounts are material to the financial statements.

4. **Deferred tax** is provided for on all temporary differences according to the statement of financial position approach. There are no other temporary differences except for those evident from the question.

5. Tax information

- 5.1. The horse and trailer is written off in full (including tyres) from the purchase date on the straight-line basis over 4 years. A scrapping allowance was allowed on the burst tyre and replacements.
- 5.2. The new tyre purchases and the major inspection costs are written off in the year that they occur.
- 5.3. There is no allowance on the office building.
- 5.4. The applicable income tax rate is 28%.

REQUIRED

Provide all the relevant disclosure in the financial statements of DEL Ltd for the year ended 31 December 20.7. Your answer must comply with the requirements of International Financial Reporting Standards (IFRS). (50)

Please note:

- Ignore comparative information
- Round off all calculations to the nearest rand.

QUESTION 2 (35 marks) (42 minutes)

Jip Ltd accounts for its properties according to the fair value model. Property, plant and equipment is accounted for according to the cost model. The following information relates to its investment properties and property, plant and equipment for the year ended 30 June 20.2:

1. **Property 1**

The fair value at the beginning of the year was R880 000, which was also the original cost price on 1 July 20.0. The value of the land, situated at erf 80, Pretoria, was R200 000 and the building was R680 000. On 1 January 20.2 the lease agreement expired under which the property was leased out and Jip Ltd took occupation of the property and occupied it for the remainder of the financial year. During the first six months it earned a monthly rental income of R12 000 and incurred operating expenses of R25 000. The fair value on 1 January 20.2 was R204 000 for the land and R696 000 for the building. On 30 June 20.2 the fair values were as follows: land R212 000 and the building R708 000. The expected useful life of the building was estimated at 20 years on 1 January 20.2. There is no residual value. The South African Revenue Service does not allow any building allowance.

2. **Property 2**

On 1 July 20.1 Jip Ltd bought a fully furnished property for R700 000 (land - R280 000; building - R420 000) which was immediately leased out for one year at R10 000 per month. The monthly direct operating expenses amounted to R4 000. The board of directors decided to redevelop and expand the property, which activity commenced on 1 October 20.1. The current lease agreement had to be cancelled and for breach of contract Jip Ltd paid R20 000 in compensation/damages to the lessee, which is not tax deductible.

The following costs relating to the property were incurred during the redevelopment phase from 1 October 20.1 to 28 February 20.2:

	R
Architect's and engineer's fees	25 000
Delivery costs of building materials	10 000
Building materials and consumables	350 000
Municipal rates and taxes on the stand	8 000
General overhead cost	20 000
Advertising costs	7 000
Furniture and equipment	185 000

The redeveloped investment property was ready for occupation on 28 February 20.2. However, it was only leased out from 1 April 20.2 at R20 000 per month. Operating expenses since 1 March 20.2 to the end of the financial year were evenly incurred and amounted to R20 000 for the full period.

The fair value of the investment property, including furniture and equipment, at the end of the year was estimated at R1 300 000 (land - R300 000; building - R1 000 000). The expected life span of the building is 50 years. The property is situated at erf 22, Midrand.

QUESTION 2 (continued)

3. Jip Ltd sold its only motor vehicle on 30 September 20.1 for R80 000. Jip Ltd paid R110 000 cash for the vehicle on 1 July 19.8. On 1 July 19.8 the residual value was estimated at R30 000 and remained unchanged every financial year. The carrying amount of the vehicle at the beginning of the current year was R50 000 and the tax base was R44 000. Both the company and the South African Revenue Service provide for depreciation/wear and tear on a straight-line basis.

4. The profit before tax of Jip Ltd for the year ended 30 June 20.2, including the above-mentioned transactions, was R200 000. Assume that all accounting entries were correctly and accurately recorded in the books of Jip Ltd.

5. The deferred tax liability at the beginning of the year was R1 680. There are no other items that would give rise to deferred tax, except those resulting from the above-mentioned circumstances. Deferred tax is provided for on all temporary differences using the statement of financial position approach.

6. Apart from the above-mentioned assets, there were no other property, plant and equipment, or investment properties recorded in the records of Jip Ltd.

7. The income tax rate is 28%.

REQUIRED

Prepare all the relevant notes to the annual financial statements of Jip Ltd for the year ended 30 June 20.2. Your answer must comply with the requirements of International Financial Reporting Standards (IFRS). (35)

No comparative figures are required.

No accounting policy notes are required.

QUESTION 3 (50 marks) (60 minutes)

Bonga Ltd is a company situated in Randburg. The company has applied IAS 40 -Investment property, to all its investment properties according to the fair value model since 20.2.

The following information with regard to immovable properties is relevant for the financial year which ended on 31 December 20.4.

1. **Office building in Randburg, erf 2001**

   Bonga Ltd bought the property for R600 000 (land - R150 000; building - R450 000) on **1 May 20.3** for its own use. On **2 May 20.3** capital expenditure was incurred on the building for the amount of R50 000. Depreciation is provided over 50 years according to the straight-line method on administration buildings. In January 20.4 the company decided to lease out the building and to rent offices for its own use for R15 000 per month. It vacated the building on 30 April 20.4 when the fair value of the property was R680 000 (land: R170 000; building: R510 000). R40 000 was spent on upgrading in May and June 20.4. The building was ready to be leased from the beginning of July 20.4. A contract for security services was binding from 1 January 20.4 until 31 December 20.4 and amounted to R1 500 a month. R8 000 was spent during July 20.4 to market the building. A lease contract was concluded effective from 1 August 20.4 at a monthly rental of R25 000. The fair value was valued at R720 000 (land: R170 000; building: R550 000) on 30 June 20.4 and R750 000 (land - R180 000; building - R570 000) on 31 December 20.4. The accountant capitalised the security and marketing costs incurred from May to December 20.4 and only deducted security costs for 4 months from profit before tax. There is no capital allowance on the building.

2. **Building in Johannesburg, erf 345**

   Bonga Ltd bought the property on 1 January 20.3 for R420 000 (land: R120 000; building: R300 000) as an investment property. Additions to the building during 20.3 amounted to R80 000. The market value on 31 December 20.3 was estimated at R535 000 (land: R135 000; building: R400 000). The property was sold on 30 September 20.4 for R560 000 (fair value of land: R145 000, and building: R415 000). Rental income for 20.4 was R160 000 (20.3: R180 000). Direct operating costs for 20.4 amounted to R20 000 (20.3: R25 000). The base cost is equal to the cost price of the asset and there is no capital allowance on the building.

3. **Residential property, erf 111, Roodepoort**

   Bonga Ltd bought land for R250 000 on 15 January 20.4 and constructed a residential building for its employees. The construction was completed on 30 June 20.4 at a cost of R500 000. All of the ten residential units were occupied from 1 July 20.4 to 31 December 20.4. The building is depreciated on the straight-line basis over 20 years.

QUESTION 3 (continued)

The South African Revenue Service will allow the following as deductions for the current tax year of the company:

	R
Accommodation allowance	60 000
Commencement allowance	44 000
Annual allowance	8 800
	112 800

Rental income for the year was R150 000 and direct operating costs amounted to R30 000.

4. Stands

On 1 March 20.4 the company bought two stands, plot 327 and 328, Randburg, for R250 000 each. The company intended to keep plot 327 for capital appreciation and plot 328 for the development of an office building for its own use. At year end the development plans had not been finalised and construction would thus only commence in 20.5. On 31 December 20.4 the stands were revalued at R260 000 each, based on market values.

5. The profit before tax for 20.4 amounted to R400 000 (20.3: R70 000), including all the transaction information given above.

6. The SA Normal tax rate is 28% (20.3: 28%). There was no deferred tax balance at the beginning of 20.3 and only the above information could have deferred tax implications. Deferred tax is provided for on all temporary differences using the statement of financial position approach. The R40 000 improvement on erf 2001 will be regarded by the South African Revenue Service as of a capital nature.

7. All properties were valued by F. Fairness, an independent sworn appraiser with a recognised and applicable professional qualification who has recent experience in the situation and category of similar properties. The fair values of the properties are based on current prices in an active market for similar properties in the same area.

8. It is the policy of the company to account for all classes of property, plant and equipment according to the cost model.

REQUIRED

Prepare the following notes to the annual financial statements of Bonga Ltd for the year ended 31 December 20.4:

- Property, plant and equipment
- Investment property
- Deferred tax
- Profit before tax

Your answer must comply with the requirements of International Financial Reporting Standards (IFRS). (50)

Ignore accounting policy notes.

QUESTION 4 (20 marks) (24 minutes)

After consultation with the research and development unit of Future Ltd, the directors of Future Ltd concluded that "Machine 2000" was physically damaged and therefore impaired on 28 February 19.8.

Details of "Machine 2000" at 28 February 19.8 (before considering impairment) were as follows:

	Cost R	Accumulated depreciation R	Carrying amount R
"Machine 2000"	4 000 000	1 200 000 (three years, 10% straight-line)	2 800 000

The amount available from the sale of "Machine 2000" in an arms' length transaction by reference to an active market is R800 000. The costs of disposing of "Machine 2000" will be R50 000.

The calculated value in use for "Machine 2000" amounted to R300 000 and no change in the estimated useful life of "Machine 2000" is necessary. The discount rate used in calculating the value in use is 16%.

Assume a tax rate of 28%. Any impairment loss is considered to be significant.

REQUIRED

(a) Calculate the impairment loss for the year ended 28 February 19.8 for "Machine 2000". (6)

Assume that there was no impairment for 19.7.

(b) Disclose the above-mentioned information in the notes to the annual financial statements of Future Ltd for the year ended 28 February 19.8. Your answer must comply with the requirements of International Financial Reporting Standards (IFRS). (14)

The accounting policy notes and notes dealing with taxes are not required.

QUESTION 5 (25 marks) (30 minutes)

AL Ltd developed a patent during the current financial year and it will be used from 1 September 20.2 in its manufacturing plant. The development was completed and ready for use on 31 May 20.2.

The following costs relating to the development of the patent were incurred during the financial year which ended on 31 August 20.2:

	R
Work outsourced to subcontractors	100 000
Personnel costs (salaries and wages)	300 000
Consumables	50 000
Water and electricity	40 000
Depreciation on machinery used	20 000
	510 000

Development costs will be expensed immediately, unless they are recoverable from future sales over the next 5 years. If so then the costs will be amortised over this period. The South African Revenue Service allows a tax allowance over 20 years on the patent, not apportioned for part of the year. The development costs met the criteria for recognition as an intangible asset.

Based on forecasts of future sales, product costs, sales costs and a before tax discount rate of 15%, the value in use of the patent at year end is estimated at R450 000. The fair value less costs to sell of the intangible asset on 31 August 20.2 was R430 000.

The current tax rate is 28%.

Profit before tax, including the above-mentioned information, is R150 000 for the current year.

On 1 September 20.1 there was a deferred tax asset of R8 400 in the records of AL Ltd. This asset was recognised for the carry forward of an unused tax loss of R30 000 on 31 August 20.1. There were no other temporary differences apart from those evident from the given information. Deferred tax is provided for on all temporary differences according to the statement of financial position approach.

The cost of the patent as well as the impairment loss is material to the financial statements of AL Ltd.

REQUIRED

Prepare all the relevant notes to the annual financial statements of AL Ltd for the year ended 31 August 20.2. Your answer must comply with the requirements of International Financial Reporting Standards (IFRS). (25)

QUESTION 6 (18 marks) (22 minutes)

S-Ware Ltd is a listed company with a 28 February year end. The primary segments for the business activities are the production and sales of software packages.

On 1 March 19.8 S-Ware Ltd acquired a licence for R2 400 000 to sell Grafic software packages for 20 years. The licence is amortised on the straight-line method. There is persuasive evidence that the economic benefits will definitely flow to the company over the time that the licence is awarded to the company.

On 31 August 19.9 a second licence to sell Grafic software packages was awarded to a competitor of S-Ware Ltd. It resulted in the reduction of the expected net cash inflow to the company to R408 360 per annum. Based on an after tax discount rate of 14% the value in use and the estimated fair value less costs to sell of the licence on 28 February 20.0 was R1 965 110 and R1 500 000 respectively. On 28 February 19.9 the recoverable amount of the licence exceeded the carrying amount thereof and on 28 February 20.1 the carrying amount and the recoverable amount of the licence were equal.

During 20.1 the competitor to whom the second licence was awarded encountered financial difficulties and was liquidated. This had a positive influence on the future expected cash inflows of S-Ware Ltd which resulted in a value in use of R2 200 000 for the licence and an expected fair value less costs to sell of R1 850 000 on 28 February 20.2.

The cost of the licence as well as the impairment loss is material to the financial statements of S-Ware Ltd.

The applicable income tax rate is 28%.

REQUIRED

a) Prepare the notes to the annual financial statements of S-Ware Ltd for the year ended **28 February 20.0**. Your answer must comply with the requirements of International Financial Reporting Standards (IFRS). (14)

Accounting policy notes are required.

Comparative figures are not required.

b) Calculate the impairment loss or reversal of the impairment loss for the year ended 28 February 20.2 in accordance with IAS 36. (4)

Calculations must be rounded to the nearest rand.

QUESTION 7 (34 marks) (41 minutes)

PART A

An investor bought 3 500 10% R200 debentures on 1 January 20.3 at R190 per debenture. The debentures are redeemable on 31 December 20.5.

Transaction costs amounted to R1 000. Interest is paid yearly at the end of each year. The year end of the investor entity is 31 December.

The cash flow of the transaction is as follows:

Cost price:	**R**
Initial payment (3 500 x R190)	665 000
Transaction cost	1 000
	666 000

Cash flow:	**Inflow/ (outflow) R**
01/01/20.3 Cost price	(666 000)
31/12/20.3 Interest received (3 500 x R200 x 10%)	70 000
31/12/20.4 Interest received (3 500 x R200 x 10%)	70 000
31/12/20.5 Interest and capital received [(3 500 x R200 x 10%) + R700 000]	770 000
Effective interest rate	12,023%

REQUIRED

Prepare the journal entries for the three years. Your answer must comply with International Financial Reporting Standards (IFRS). (24)

PART B

The financial director of Gariep Ltd approached you for advice on the accounting treatment of the following foreign exchange currency transactions for the year ended 28 February 20.2.

The company ordered inventory to the value of £42 800 on 1 January 20.2 from the United Kingdom. The inventory was delivered FOB on 1 April 20.2. The settlement date is one month after delivery.

On 1 January 20.2 a four month forward exchange contract (FEC) was taken out for payment of the full amount.

Assume that the company meet the hedging criteria of IAS 39.88 in order to apply hedge accounting.

QUESTION 7 (continued)

The company's documented risk management strategy for foreign currency risks provides for the following:

- all exposure to fluctuations in foreign exchange rates are to be hedged by means of forward exchange contracts,

- hedge effectiveness is to be assessed on an ongoing cumulative basis from the inception of the hedge by comparing the offsetting effects of gains or losses arising from fluctuations in spot exchange rates to those arising from changes in the fair value of forward exchange contracts designated in their entirety.

- it is company policy to remove associated gains and losses that were recognised directly in equity and include them in the initial cost of the non-financial asset that subsequently results from the hedge of the forecasted transaction.

Assume that 10% of the cash flow hedge is ineffective and 90% effective.

The following spot rates were applicable:

1 January 20.2	£1 = R12,40
28 February 20.2	£1 = R12,60
1 April 20.2	£1 = R12,70
1 May 20.2	£1 = R12,75

The applicable forward rates were:

1 January 20.2	£1 = R12,45 (4 months)
28 February 20.2	£1 = R12,64 (2 months)
1 April 20.2	£1 = R12,76 (1 month)

REQUIRED

Discuss, by using journal entries, the accounting treatment of the foreign currency contract regarding the buying of inventory from 28 February 20.2 until payment in the accounting records of Gariep Ltd according to International Financial Reporting Standards (IFRS). (10)

QUESTION 8 (45 marks) (54 minutes)

The following is an extract from the trial balance of South Coast Ltd for the year ended 31 December 20.2:

	Information reference	R
Revenue		305 500
Cost of sales		(185 900)
Dividends received - unlisted (30/06/20.2)		7 856
Depreciation - plant	8	(16 000)
- equipment		(4 000)
Other expenses	11	(58 000)

Additional information

1. South Coast Ltd is involved in two different main categories of business: the production and marketing of surf-boards and the preparation and supply of exotic seafood dishes to retailers.

2. On 13 May 20.2 the directors decided and approved a detailed plan to discontinue the operations and sell the assets regarding the production and marketing of surf-boards and to concentrate on the food processing operations. On 1 December 20.2 a public announcement was made to confirm the disposal plan of the assets of the surf-board operation. The assets were ready for immediate sale from that date and an active marketing plan was initiated.

3. It is expected that the process of discontinuance will be concluded on 18 February 20.3.

4. In accordance with a binding sales agreement the plant of the surf-board operation was sold on 15 December 20.2 for R42 000. Details of the plant were as follows:

	R
Carrying amount (01/01/20.2)	24 000
Tax value (01/01/20.2)	13 333
Cost	40 000

Depreciation on this asset must still be provided for the current year.

5. Details of the only other assets of the surf-board operation that have to be sold to independent parties on 1 February 20.3 according to binding sales agreements, are as follows:

	Cost price R	Purchase date	Carrying amount R	Tax value R	Contract price R
Truck	30 000	01/01/20.1	20 000	22 500	8 000
Equipment	10 000	01/01/19.9	7 000	4 000	6 000

Depreciation on these assets must still be provided for the current year. The assets will be withdrawn from use on 31 December 20.2.

QUESTION 8 (continued)

6. The assets used in the food processing operations are as follows:

	Cost price R	Purchase date	Carrying amount R	Tax base R	Value in use R	Fair value less costs to sell R
Land (31/12/20.2)	20 000	01/01/20.1	20 000	-	20 000	20 000
Plant (31/12/20.2)	80 000	01/01/20.1	48 000	26 667	40 000	45 000
Equipment (31/12/20.2)	40 000	01/01/20.0	28 000	16 000	30 000	23 000

Tax allowances for the year amount to R26 667 on plant and R8 000 on equipment.

7. The results of the surf-board operations were as follows:

	01/01/20.3 - 18/02/20.3 R Expected	01/12/20.2 - 31/12/20.2 R Actual	14/05/20.2 - 01/12/20.2 R Actual	01/01/20.2 - 13/05/20.2 R Actual
Revenue	1 800	3 000	42 000	59 000
Cost of sales	(3 500)	(2 900)	(42 000)	(65 000)
Other expenses	(500)	(1 000)	(25 000)	(21 000)
Proceeds from sale of plant		42 000		
Direct cost of discontinuance	(1 200)	(800)		
Severance package to employees	(20 000)	(2 000)		

The company only operates on a cash basis.

8. For accounting purposes plant is depreciated over a period of 5 years on the straight-line basis. According to Section 12C the applicable tax allowance is over 3 years.

   Equipment is depreciated for accounting purposes over a period of 10 years on the straight-line basis and the SA Revenue Service allows a tax allowance over 5 years on the straight-line basis.

   Trucks are depreciated over a period of 3 years on the straight-line basis for accounting purposes and the SA Revenue Service allows a tax allowance over 4 years, on the straight-line basis.

   Land is not depreciated for accounting or tax purposes.

9. The South African Revenue Service only allows the direct cost for the discontinuance paid during the year as a deduction. Severance pay to employees is only deductible for tax purposes when paid to the employees.

QUESTION 8 (continued)

10. There are no temporary differences other than those indicated in the question. Deferred tax is provided for on all temporary differences by using the statement of financial position approach.

11. Included in other expenses of the surf-board operations, is R5 000 that South Coast Ltd paid to North Coast Ltd, its competitor due to a litigation settlement, for the infringement of a patent held by North Coast Ltd. This settlement is not deductible for tax purposes and relates to the surf-board section.

12. Assume an income tax rate of 28%.

13. You can assume that all assets were purchased after capital gains tax came into effect.

14. Depreciation can be considered as part of other expenses. All other depreciations that can not specifically be calculated are also tax deductible.

15. Round all amounts to the nearest rand.

REQUIRED

(a) Prepare the statement of profit or loss and other comprehensive income of South Coast Ltd for the year ended 31 December 20.2 according to the requirements of International Financial Reporting Standards (IFRS). Distinguish on a column basis in the statement of profit or loss and other comprehensive income between continued and discontinued operations. (25)

(b) Prepare the notes for the year ended 31 December 20.2 regarding the following: (14)
- tax expense
- non-current assets held for sale

(c) Discuss the effect of the announcement on 1 December 20.2 on the comparative figures which would have been presented in the financial statements. (3)

(d) Discuss the effect on the financial statements if the announcement had been made on 1 February 20.3 before the financial statements were approved for publication. (3)

Note:
The following notes are not required:
- Accounting policy.

Comparative figures are not required.

QUESTION 9 (32 marks) (38 minutes)

The following information for the year ended 31 December 20.2 was taken from the records of Addo Ltd:

	20.2
	R
Revenue	1 000 000
Cost of sales	(470 000)
Other expenses	(351 500)
Finance costs	(8 000)
Direct costs of discontinuance	(3 400)

All the above items are subject to tax.

Included in the above-mentioned figures are the results of the clothing segment which has not come up to expectations since 20.0. A detailed, formal plan for the discontinuance and disposal of the operations of the segment was approved by the board of directors on 30 September 20.2 and they made an announcement concerning the discontinuance on the same date. The assets and liabilities of the clothing segment will be sold. It is expected that the sale will be completed on 1 March 20.3. The results of the clothing segment which were previously reported in the RSA segment, are as follows:

	01/10/20.2 to 31/12/20.2	**01/01/20.2 to 30/09/20.2**
	R	**R**
Revenue	38 200	42 600
Cost of sales	29 000	30 000
Other expenses	23 500	24 620
Direct costs of discontinuance	3 400	-

The following are the estimates concerning the clothing segment:

	01/01/20.3 to 01/03/20.3
	R
Direct costs of discontinuance	1 900
Profit before tax	10 000

QUESTION 9 (continued)

Additional information

1. On 15 November 20.2 Addo Ltd signed a contract in terms of which all the assets and liabilities of the clothing segment will be taken over on 1 March 20.3 at the following values:

	Carrying amount 15/11/20.2 R	**Contract price based on current market prices R**
Property, plant and equipment	120 000	107 000
Inventory	20 000	20 000
Trade Receivables	30 000	25 700

In terms of the contract all the trade payables of the clothing segment will be taken over for the amount of R25 000. Any provisions regarding the discontinuance will be taken over in terms of the contract.

The difference between the carrying amount and the contract price of the trade receivables arose because the recoverability of R4 300 is uncertain. This doubtful recoverability is the direct consequence of the decision to discontinue the operations of the branch. The R4 300 will be allowed as a deduction for tax purposes in the current financial year.

The group meets all the criteria to be classified as a disposal group.

2. Assume that the South African Revenue Service allows all direct costs of discontinuance as a tax deduction.

3. Deferred tax is provided for on all temporary differences using the statement of financial position approach.

4. The income tax rate is 28%.

5. There are no other non taxable/non tax deductible (exempt) or temporary differences, except those evident from the question.

REQUIRED

Prepare the statement of profit or loss and other comprehensive income and the following notes to the annual financial statements of Addo Ltd for the year ended 31 December 20.2:

1. Income tax expense (ignore the tax rate reconciliation)
2. Non-current assets held for sale/disposal group (32)

Your answer must comply with the requirements of International Financial Reporting Standards (IFRS).

Round off all calculations to the nearest rand.

QUESTION 10 (40 marks) (48 minutes)

The abridged trial balance of Sivet Ltd for the year ended 31 December 20.2 is as follows:

	Dr/(Cr) R
Issued share capital	(200 000)
Retained earnings on 1 January 20.2	(596 750)
Land	150 000
Buildings	450 000
Machinery	280 000
Accumulated depreciation on machinery	(112 000)
Trade Receivables	50 000
Inventory	30 000
Bank	24 300
Creditors (excluding the South African Revenue Service)	(42 000)
Payment to overseas creditor	149 250
Amount paid to bank iro the renewal of forward exchange contract	200
Profit before depreciation and tax	(300 000)
Depreciation	56 000
Provisional tax payments	61 000
	-

Additional information

1. On 15 July 20.2 Sivet Ltd bought new machinery from a European supplier for €25 000. The machinery was shipped free-on-board (FOB) on 1 August 20.2, the date on which Sivet Ltd became irrevocably party to the contract. The machinery arrived on 15 September 20.2 and was put into service on 1 October 20.2.

   The debt will be repaid as follows:

	€
30 September 20.2	15 000
31 January 20.3	10 000
	25 000

   On 1 October 20.2 the company entered a two month foreign exchange contract (FEC) in respect of the debt that is payable on 31 January 20.3. On 1 December 20.2 this FEC was rolled forward for a further two months.

   This transaction has not yet been recorded in Sivet Ltd's records, except for the payment to the overseas supplier on 30 September 20.2 and the amount paid to the bank on 1 December 20.2 with the forward roll of the FEC.

QUESTION 10 (continued)

2. The company provides for depreciation on machinery at 20% per annum according to the straight-line method. The South African Revenue Service allows for a tax allowance over 5 years.

3. On 31 August 20.2 Sivet Ltd borrowed €20 000 for the partial finance of the purchase of the machinery (described in 1). The terms of the loan contract were as follows:

   - term of loan 1 year
   - interest rate 5%
   - interest is payable annually in arrears on 31 August 20.3
   - the capital is repayable on 31 August 20.3.

   No forward exchange contract has been taken out on the transaction.

   This transaction has not yet been recorded in Sivet Ltd's records.

4. The income tax rate is 28%.

5. There was no deferred tax balance on 1 January 20.2 in Sivet Ltd's records.

6. The exchange rates on the relevant dates were as follows:

	Spot rate €1 = R	**Two month FEC €1 = R**
15 July 20.2	9,90	
01 August 20.2	9,80	
31 August 20.2	9,83	
15 September 20.2	9,85	
30 September 20.2	9,95	9,98
01 October 20.2	9,96	10,05
01 December 20.2	10,03	10,10
31 December 20.2	10,08	
31 January 20.3	10,15	
31 August 20.3	10,25	

   The forward rate for a one month FEC on year-end is €1 = R10,12.

7. Assume the hedging criteria per IAS 39.88 have been met.

   The company's documented risk management strategy for foreign currency risks provides for the following:

   - all exposure to fluctuations in foreign exchange rates are to hedged by means of forward exchange contracts,

QUESTION 10 (continued)

- hedge effectiveness is to be assessed on an ongoing cumulative basis from the inception of the hedge by comparing the offsetting effects of gains or losses arising from fluctuations in spot exchange rates to those arising from changes in the fair value of forward exchange contracts designated in their entirety.

- it is company policy to remove associated gains and losses that were recognised directly in equity and include them in the initial cost of the non-financial asset that subsequently results from the hedge of the forecasted transaction.

8. Assume that the South-African Revenue Services allows the interest expense (in terms of section 24J) and all the exchange differences (in terms of section 24I) as recorded in Sivet Ltd's records on 31 December 20.2

REQUIRED

(a) Prepare all the relevant journal entries up to and including 31 August 20.3.

(b) Prepare the statement of financial position, statement of profit or loss and other comprehensive income and all the notes relating to foreign exchange in the annual financial statements of Sivet Ltd for the year ended 31 December 20.2. Your answer must comply with the requirements of International Financial Reporting Standards (IFRS).

4 SUGGESTED SOLUTIONS TO ADDITIONAL QUESTIONS

SUGGESTED SOLUTION QUESTION 1

DEL LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 2007

1. Basis of preparation

The financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

The financial statements have been prepared on the historical cost basis and restated for revaluations of land and buildings.

2. Accounting policy

The principal accounting policies which are followed by the company and which are consistent with those of the previous years are set out below:

2.1 Property, plant and equipment

Property, plant and equipment are initially accounted for at cost.

Land and buildings are subsequently carried at their revaluated amounts, namely the fair value at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses. Revaluations are performed every two years to ensure that the carrying amount does not differ materially from the fair value amount at the reporting date. Any increase in the revaluation surplus is recognised in other comprehensive income and accumulated in equity. Any accumulated depreciation at the date of the revaluation is eliminated against the gross carrying amount of the asset [i.e. the net replacement method] and the net amount is restated to the revalued amount of the asset. The revaluation surplus realises as the asset is used by the company and a transfer is made from the net revaluation surplus to retained earnings, being the difference between the depreciation based on the gross carrying amount [i.e. the net replacement value].and that based on the original cost of the asset. On disposal, the net revaluation surplus is transferred to retained earnings.

Land is not depreciated. The building is depreciated on a straight-line basis over the expected useful life of 30 years.

Vehicles are subsequently measured at historical cost less accumulated depreciation and accumulated impairment losses.

Vehicles are depreciated on a straight-line based on the expected useful life thereof.

The residual values and expected useful lives of all items of property, plant and equipment are reviewed at each reporting date and adjusted if necessary.

Depreciation on impairment losses are charged to profit or loss.

SUGGESTED SOLUTION QUESTION 1 (continued)

2.2 Tax

Current and deferred tax are recognised as income or expense and included in profit or loss for the period, except when the tax relates to items that are recognised outside profit or loss. Tax that relates to items that are recognised in other comprehensive income or directly in equity, are also recognised respectively in comprehensive income or directly in equity.

Deferred tax
Deferred tax is provided for on all temporary differences according to the statement of financial position approach and based on tax rates that have been enacted or substantively enacted by the reporting date. The measurement of deferred tax reflect the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of its assets and liabilities at the reporting date.

Temporary differences are the differences between the carrying amount of assets and liabilities [in the financial statements] and their corresponding tax bases used for tax purposes [for the calculation of taxable income].

Deferred tax liabilities are accounted for on all taxable temporary differences, except for the initial recognition of goodwill or the initial recognition of an asset or liability which is not a business combination and which at the time of the transaction affects neither accounting profit nor taxable income / tax loss.

Current tax
Current tax payable or recoverable for the current and prior periods is measured at the amount expected to be paid or recovered from the tax authorities, using the tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period [i.e. according to the Income Tax Act].

3. Property, plant & equipment	**Motor Vehicle**	**Land**	**Building**	**Total**
	R	**R**	**R**	**R**
Carrying amount at the beginning of the period	-	1 700 000	1 192 500	2 892 500
Gross carrying amount	-	1 700 000	1 200 000	2 900 000
Accumulated depreciation	-	-	(7 500)	(7 500)
Additions	634 000	-	-	634 000
Revaluations (calc 5, 6 and 7)	-	250 000	214 100	464 100
Capitalisation of additional cost (calc 2, 4)	90 700	-	-	90 700
Depreciation (calc 1 - 4) (calc 6)	(226 715)	-	(36 600)	(263 315)
Derecognition (impairment) (calc 4)	(1 500)	-	-	(1 500)
Carrying amount at the end of the period	496 485	1 950 000	1 370 000	3 816 485
Gross carrying amount (calc 1 - 4)	638 700	1 950 000	1 406 600	3 995 300
Accumulated depreciation	(142 215)	-	(36 600)	(178 815)

SUGGESTED SOLUTION QUESTION 1 (continued)

Land and building are revalued by XY Valuers, sworn appraisers. The valuation was performed on 31 December 2007.

The carrying amount of the land and building, if they were carried at historical cost less accumulated depreciation and impairment losses, would have amounted to R1 700 000 for the land and R1 163 097 for the building (calc 5 & 6).

4. Deferred tax

	R
Land [(1 950 000 – 1 700 000) x 66.6% x 28%]	46 620
Building [(1 370 000 – 1 163 097) x 28%)	57 933
Horse [(157 500 – 146 250) x 28%]	3 150
Engine [(163 040 – 162 500) x 28%]	151
Trailer [(131 250 – 121 875) x 28%]	2 625
Tyres [(44 695 – 32 500) x 28%]	3 415
Deferred tax liability at the end of the period	113 894

OR

Analysis of temporary differences:	
Land:	
- Revaluation (250 000 x 66,6% x 28%)	46 620
Building:	
- Revaluation (206 903 x 28%)	57 933
- Accelerated tax allowance (**Office building therefore exempt)**	
Horse:	
- Accelerated tax allowance (11 250 x 28%)	3 150
Engine:	
- Accelerated tax allowance [(143 240 + 19 800) – 162 500] x 28%	151
Trailer:	
- Accelerated tax allowance (131 250 – 121 875) x 28%	2 625
Tyres:	
- Accelerated tax allowance [(3 333 + 41 362) -32 500] x 28%	3 415
Deferred tax liability at the end of the period	113 894

5. Revaluation surplus (column in statement of changes in equity)

	R
Balance at the beginning of the period	-
Other comprehensive income (in statement of profit or loss and other comprehensive income) [464 100 (revaluation - note 2) - 106 568 (def. tax) (land: 46 620, building: 59 948)]	357 532
Transfer to retained earnings (realisation) [(214 100 - 59 948) / 357 months x 12 months]	(5 182)
Balance at the end of the period	352 350

SUGGESTED SOLUTION QUESTION 1 (continued)

6. Profit before tax

Included in profit before tax are the following items:

	R
Depreciation (calc 3)	263 315
Derecognition / impairment of asset	1 500

Included in depreciation is a change in estimate of R597 (decrease) arising from the increase in the estimated residual value of the building. This change will result in a decrease in depreciation of R17 153 in future periods (calc 8) (IAS 8.32-40).

7. Income tax expense

Major components of tax expense	R
Current tax (calc 9)	196 907
Deferred tax (calc 10)	7 326
SA normal tax expense	204 233

Tax rate reconciliation

	R
Standard tax on profit before taxation (700 000 x 28%) (given)	196 000
Add: non-deductible expenses (depreciation on administration building) (calc 6)	8 233
SA normal tax (calc 9)	204 233

CALCULATIONS

1. Horse

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) R
Cost on 1 April 2007	180 000	180 000		
Depreciation / tax allowance	(22 500)	(33 750)		
Carrying amount on 31 December 2007	157 500	146 250	11 250	(3 150)

SUGGESTED SOLUTION QUESTION 1 (continued)

2. Engine

	Engine carrying amount R	Major inspection cost R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) R
Cost on 1 April 2007	178 000	22 000	200 000		
Depreciation inspection (total amount)	-	(22 000)[a]	-		
Capitalisation of new cost	-	22 000	-		
Depreciation on inspection cost (5 000 km)	-	(2 200)[b]	-		
Depreciation on engine (55 000 km)	(34 760)[c]	-	(37 500)[d]		
Carrying amount on 31 December 2007	143 240	19 800	162 500	540	(151)

a. 22 000 / 50 000 x 50 000 = 22 000
b. 22 000 / 50 000 x 5 000 = 2 200
c. (178 000 – 20 000) x 55 000 / 250 000 = 34 760
d. 200 000 / 4 x 9 / 12 = 37 500

3. Trailer

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) R
Cost on 1 April 2007	150 000	150 000		
Depreciation / tax allowance	(18 750)[e]	(28 125)[f]		
Carrying amount on 31 December 2007	131 250	121 875	9 375	(2 625)

e. (150 000 – 25 000) / 5 x 9/12 = 18 750
f. 150 000 / 4 x 9 / 12 = 28 125

SUGGESTED SOLUTION QUESTION 1 (continued)

4. Tyres

	Carrying amount Tyres: horse R	Carrying amount Tyres: trailer R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) R
Cost on 1 April 2007	40 000	64 000	104 000		
Depreciation: horse (55 000 km)	(36 667)[g]	-	(7 500)[h]		
Depreciation: burst tyre	-	(2 500)[i]	(333)[j]		
Derecognition / scrapping: burst tyre	-	(1 500)[k]	(3 667)		
Capitalisation of new tyre	-	4 200	-		
Depreciation: new tyre (30 000 km)	-	(3 150)[l]	-		
Depreciation: trailer (40 000 km)	-	(60 000)[m]	(8 750)		
Scrapping: old tyres	-	-	(51 250)[n]		
Capitalisation of new tyres (15 x 4 300)	-	64 500	-		
Depreciation: new tyres (15 000 km)	-	(24 188)[o]	-		
Carrying amount on 31 December 2007	3 333	41 362	32 500	12 195	(3 415)

g. 40 000 x 55 000 / 60 000 = 36 667
h. 40 000 / 4 x 9 / 12 = 7 500
i. 4 000 / 40 000 x 25 000 = 2 500
j. 4 000 / 4 x 4 / 12 = 333
k. 4 000 – 2 500 = 1 500
l. 4 200 / 40 000 x 30 000 = 3 150
m. 60 000 / 40 000 x 40 000 = 60 000
n. 64 000 – 333 – 3 667 – 8 750 = 51 250
o. 64 500 / 40 000 x 15 000 = 24 188

5. Land

	Total R	Revaluation R	Historical R	Tax base R	Exempt difference R	Temporary difference R	Deferred tax asset/ (liability) R
Cost on 30 September 2006	1 700 000	-	1 700 000	-	1 700 000		
Revaluation 2007	250 000	250 000	-	-	-		
Carrying amount on 1 December 2007	1 950 000	250 000	1 700 000		1 700 000	250 000	(46 620)

SUGGESTED SOLUTION QUESTION 1 (continued)

6. Building

	Total R	Revaluation R	Historical R	Tax base R	Exempt difference R	Temporary difference R	Deferred tax asset/ (liability) R
Cost	1 200 000	-	1 200 000	1 200 000	-		
30 September 2006							
Depreciation 2006	(7 500)	-	(7 500)	-	(7 500)		
Carrying amount 31 December 2006	1 192 500	-	1 192 500	1 200 000	(7 500)		
Revaluation 2007 (calc 7)	214 100	214 100	-	-	-		
Gross Carrying amount 1 January 2007	1 406 600	214 100	1 192 500	1 200 000	(7 500)	214 100	(59 948)
Depreciation 2007	(36 600)[p]	(7 197)[q]	(29 403)[r]	-	(29 403)		
Carrying amount 31 December 2007	1 370 000	206 903	1 163 097	1 200 000	(36 903)	206 903	(57 933)

p. [(1 406 600 – 317 750) / 357] x 12 = 36 600
q. (214 100 / 357) x 12 = 7 197
r. [(1 192 500 – 317 750) / 357] x 12 = 29 403

7. Revaluation on building

	R
Net replacement value on 31 December 2007 (given)	1 370 000
Less: estimated residual value (given)	(317 750)
Depreciable amount over 345 months (30 years - 1 year and 3 months)	1 052 250
Depreciable amount at the beginning of the period (1 052 250 x 357 / 345)	1 088 850
Add: residual value	317 750
Gross carrying amount at the end of the period	1 406 600

8. Change in estimate of the residual value on the building

	R
Change in residual value (317 750 - 300 000)	17 750
Decrease in depreciation per month (17 750 / 357 remaining months)	49,72
Decrease in depreciation of 2007 (49,72 x 12) (rounded)	597
Decrease in depreciation of future periods (49,72 x 345 months)	17 153

OR:

	R
Carrying amount at the beginning of the period (calc 6)	1 192 500
Less: Residual value before change in estimate	(300 000)
Depreciable amount over 29 years and 9 months (357 months)	892 500
Depreciation for 2007 (892 500 / 357 x 12)	30 000

SUGGESTED SOLUTION QUESTION 1 (continued)

	R
Carrying amount at the beginning of the period (calc 6)	1 192 500
Less: Residual value after change in estimate	(317 750)
Depreciable amount over 29 years and 9 months (357 months)	874 750
Depreciation for 2007 (874 750 / 357 x 12)	29 403
Decrease in depreciation for 2007 (30 000 - 29 403)	597
Decrease in depreciation in future periods	17 153
[862 500 (892 500 - 30 000) - 845 347 (874 750 - 29 403)]	

9. Income tax expense

	R
Profit before tax (given)	700 000
Add: non-deductible depreciation on administration building (on historical cost – calc 6)	29 403
	729 403
Temporary differences (excluding revaluation taken to other comprehensive income)	(26 163)
Depreciation on assets full revaluation (calc 6; also compare calc 5 after tax)	7 197
Depreciation on horse (calc 1)	22 500
Tax allowance on horse (calc 1)	(33 750)
Depreciation on engine (calc 2)	34 760
Depreciation on major inspection cost (calc 2)	24 200
Tax allowance on engine (calc 2)	(37 500)
Inspection cost as expense (given)	(22 000)
Depreciation on trailer (calc 3)	18 750
Tax allowance on trailer (calc 3)	(28 125)
Depreciation on tyres (calc 4)	126 505
Derecognition of burst tyre (calc 4)	1 500
Tax allowance on tyres (calc 4)	(16 583)
Scrapping of burst and old tyres (calc 4)	(54 917)
Write off of new tyres as expense (given) (4 200 + 64 500)	(68 700)
Taxable income	703 240
Current tax (703 240 x 28%)	196 907

LECTURER'S COMMENT

The total depreciation on the tyres is R226 715 (as disclosed in note 3). In the tax calculation above it is shown separately to compare it to every individual tax treatment.

SUGGESTED SOLUTION QUESTION 1 (continued)

10. Deferred tax movement

	R dr/(cr)
Balance at the beginning of the period	-
Other comprehensive income (gain on revaluation) (note 5) (calc 5, 6)	(106 568)
Statement of profit or loss and other comprehensive income (calc 9) (debit P/L, credit SFP)	(7 326)
Balance at the end of the period (calc 1 – 6)	(113 894)

LECTURER'S COMMENT

For all the capital gains tax calculations use 28% x 66,6% to ensure that rounding does not affect your answer. Do not round the CGT rate.

SUGGESTED SOLUTION QUESTION 2

JIP LTD

NOTES FOR THE YEAR ENDED 30 JUNE 20.2

2. Property, plant and equipment

	Motor vehicle R	**Land R**	**Buiding R**	**Total R**
Carrying amount at beginning of year	50 000	-	-	50 000
Gross carrying amount	110 000	-	-	110 000
Accumulated depreciation	(60 000)	-	-	(60 000)
Transfer from investment property	-	204 000	696 000	900 000
Depreciation (calc 4) (696 000/20 x 6/12)	(5 000)	-	(17 400)	(22 400)
Disposal	(45 000)	-	-	(45 000)
Carrying amount at end of year	-	204 000	678 600	882 600
Gross carrying amount	-	204 000	696 000	900 000
Accumulated depreciation	-	-	(17 400)	(17 400)

3. Investment property

Land and building	**Property 1 R**	**Property 2 R**	**Total R**
Carrying amount at beginning of year	880 000	-	880 000
Addition (given)	-	700 000	700 000
Redevelopment (calc 3)	-	570 000	570 000
Fair value adjustment (900 000 - 880 000); (calc 3)	20 000	30 000	50 000
Transfer to property, plant and equipment	(900 000)	-	(900 000)
Carrying amount at end of year	-	1 300 000	1 300 000

The investment property was valued by XXX (the name of the valuer) on XXX (date of valuation).

LECTURER'S COMMENT

IAS 40 requires that only one figure should be disclosed for investment property and not the different properties separately as is the case above. The way it is done here in the answer is simply for educational purposes. However, you will not be penalised if you show it separately in the exam, as long as the **total** is also given.

SUGGESTED SOLUTION QUESTION 2 (continued)

4. Deferred tax

	R
Property 1: Land [(204 000 – 200 000) x 28% x 66,6%]	746
Property 1: Building [(696 000 – 680 000) x 28% x 66,6%]	2 984
Property 2: Land [(300 000 – 280 000) x 28% x 66,6%]	3 730
Property 2: Building [(1 000 000 – 990 000) x 28% x 66,6%]	1 865
Deferred tax liability	9 325

	R
Fair value adjustment: land (calc 2) (746 + 3 730)	4 476
Fair value adjustment: building (calc 2) (2 984 + 1 864)	4 848
Deferred tax liability	9 325

5. Profit before tax

Profit before tax includes the following items:

	R
Income	
Profit on sale of motor vehicle (calc 4.3)	35 000
Rental income from investment property [(12 000 x 6) + (10 000 x 3) + (20 000 x 3)]	162 000
Expenses	
Direct operating expenses on investment property that earned rental income [25 000 + (4 000 x 3) + (20 000/4 x 3)]	52 000
Direct operating expenses on investment property that did not earn rental income (8 000 + 7 000 + 5 000)	20 000
Depreciation (note 2) (5 000 + 17 400)	22 400
Compensation for breach of contract	20 000

6. Income tax expense

	R
Major components of tax expense	
Current tax (calc 1)	54 152
Deferred tax (calc 2)	7 645
SA normal tax expense	61 797

SUGGESTED SOLUTION QUESTION 2 (continued)

Tax rate reconciliation

	%	OR	R
Standard tax (200 000 x 28%)	28,00		56 000
Exempt differences			
- Compensation [20 000 x 28%];[5 600/200 000 x 100]	2,80		5 600
- Depreciation not deductible [17 400 x 28%]; [4 872/200 000 x 100]	2,44		4 872
- Fair value adjustment: land [(4 000 + 20 000) x 33,4% x 28%]; [2 244/200 000 x 100]	(1,12)		(2 244)
- Fair value adjustment: building [(16 000 + 10 000) x 33,4% x 28%] [2 432/200 000 x 100]	(1,22)		(2 432)
Effective rate / effective tax	30,90		61 796

CALCULATIONS

1. Taxable income

	R
Profit before tax (given)	200 000
Exempt differences:	
compensation for breach of contract (not tax deductible)	20 000
depreciation not deductible (note 2)	17 400
fair value adjustment: land (note 3, calc 2) [(4 000 + 20 000) x 33,4%]	(8 016)[1]
fair value adjustment: building (note 3, calc 2) [(16 000 + 10 000) x 33,4%]	(8 684)[1]
	220 700
Temporary differences	(27 300)
Depreciation - motor vehicle (note 2, calc 4)	5 000
Tax allowance - motor vehicle (calc 4)	(5 500)
Recoupment of tax on vehicle sold (calc 4)	41 500
Accounting profit on vehicle sold (note 5, calc 4)	(35 000)
Fair value adjustment: land (note 3, calc 2) [(4 000 + 20 000) x 66,6%)	(15 984)[1]
Fair value adjustment: building (note 3, calc 2) [(16 000 + 10 000) x 66,6%]	(17 316)[1]
Taxable income	193 400
Current tax (193 400 x 28%)	54 152

LECTURER'S COMMENT

1 IAS 12 presumes that the recovery of the carrying amount of investment properties carried at fair value will normally be through sale. Deferred tax will thus be provided for on 66,6% x 28% on the fair value adjustments of both land and buildings.

SUGGESTED SOLUTION QUESTION 2 (continued)

2. Deferred tax

Property 1	**Carrying amount R**	**Tax base R**	**Exempt difference R**	**Temporary difference R**	**Deferred tax asset/ (liability) R**
Opening balance on 1 July 20.1	880 000	-	880 000		
Fair value adjustment: land (note 3)	4 000	-	-		
Fair value adjustment: building (note 3)	16 000	-	-		
	900 000	-	880 000	20 000	(3 730)

20 000 x 66,6% x 28% = 3 730

Property 2	**Carrying amount R**	**Tax base R**	**Exempt difference R**	**Temporary difference R**	**Deferred tax asset/ (liability) R**
Cost (note 3) (calc 3)	1 270 000	-	1 270 000		
Fair value adjustment: land (note 3)	20 000	-	-		
Fair value adjustment: building (note 3)	10 000	-	-		
	1 300 000	-	1 270 000	30 000	(5 595)

30 000 x 66,6% x 28% = 5 595

Vehicle	**Carrying amount R**	**Tax base R**	**Temporary difference R**	**Deferred tax asset/ (liability) R**
Opening balance on 1 July 20.1 (given)	50 000	44 000		
Depreciation/tax allowance (calc 4)	(5 000)	(5 500)		
Sold	(45 000)	(39 500)		
	-	-	-	-

Deferred tax movement

	R dr / (cr)
Balance at the beginning of the period	(1 680)
Balance at the end of the period	(7 645)
Movement for the period through the statement of profit or loss and other comprehensive income in the profit or loss section (debit P/L, credit SFP)	9 325

SUGGESTED SOLUTION QUESTION 2 (continued)

3. Investment property 2

	R	
Cost - 1 July 20.1	700 000	
Redevelopment costs capitalised	570 000	
Fees of architects and engineers		25 000
Delivery costs		10 000
Building material and consumables		350 000
Furniture and equipment		185 000
Cost - 30 June 20.2	1 270 000	
Valuation	1 300 000	
Fair value adjustment	30 000	

4. Disposal of vehicle

4.1 Depreciable amount	**Accoun-ting R**	**Tax R**
Cost	110 000	110 000
Residual value	(30 000)	-
	80 000	110 000

4.2 Carrying amount	**Accoun-ting R**	**Tax R**
Cost	110 000	110 000
Accumulated depreciation (20 000 x 3)(22 000 x 3)	(60 000)	(66 000)
Carrying amount - 1 July 20.1 (given)	50 000	44 000
Depreciation/tax allowance - current year (20 000 x 3/12)(22 000 x 3/12)	(5 000)	(5 500)
Carrying amount - 30 September 20.1	45 000	38 500

4.3 Profit/recoupment on sale of vehicle	**Accoun-ting R**	**Tax R**
Carrying amount - 30 September 20.1	45 000	38 500
Selling price	80 000	80 000
Profit/recoupment	35 000	41 500

LECTURER'S COMMENT

For all the capital gains tax calculations use 28% x 66,6% to ensure that rounding does not affect your answer. Do not round the CGT rate.

SUGGESTED SOLUTION QUESTION 3

BONGA LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.4

1. Property, plant and equipment

20.4	**Land R**	**Buildings R**	**Total R**
Carrying amount at beginning of year	150 000	493 333	643 333
Gross carrying amount	150 000	500 000	650 000
Accumulated depreciation	-	(6 667)	(6 667)
Additions (erven 111, 328 and 2001) (250 000 + 250 000); (500 000)	500 000	500 000	1 000 000
Depreciation (erven 2001 and 111) (500 000 x 2% x 4/12) + (500 000 X 5% x 6/12)	-	(15 833)	(15 833)
Revaluation (erf 2001) (170 000 - 150 000); [510 000 - (493 333 - 3 333)]	20 000	20 000	40 000
Transfer to investment property	(170 000)	(510 000)	(680 000)
Carrying amount at end of year	500 000	487 500	987 500
Gross carrying amount (erven 111 and 328)	500 000	500 000	1 000 000
Accumulated depreciation	-	(12 500)	(12 500)

20.3	**Land R**	**Buildings R**	**Total R**
Carrying amount at beginning of year	-	-	-
Gross carrying amount	-	-	-
Accumulated depreciation	-	-	-
Additions	150 000	500 000	650 000
Depreciation (500 000 x 2% x 8/12)	-	(6 667)	(6 667)
Carrying amount at end of year	150 000	493 333	643 333
Gross carrying amount	150 000	500 000	650 000
Accumulated depreciation	-	(6 667)	(6 667)

2. Investment property

20.4	**Land R**	**Building R**	**Total R**
Carrying amount at beginning of year	135 000	400 000	535 000
Addition (erf 327)	250 000	-	250 000
Transfer from property, plant and equipment (erf 2001)	170 000	510 000	680 000
Redevelopment (erf 2001)	-	40 000	40 000
Fair value adjustments (land: 10 000 + 10 000)	20 000	20 000	40 000
Disposal (erf 345)	(135 000)	(400 000)	(535 000)
Carrying amount at end of year	440 000	570 000	1 010 000

SUGGESTED SOLUTION QUESTION 3 (continued)

	Land	Building	Total
20.3	**R**	**R**	**R**
Carrying amount at beginning of year	-	-	-
Additions (buildings: 300 000 + 80 000) (erf 345)	120 000	380 000	500 000
Fair value adjustment	15 000	20 000	35 000
Carrying amount end of year	135 000	400 000	535 000

Investment property was valued on 31 December 20.4 by a sworn appraiser, F Fairness.

LECTURER'S COMMENT

Comment on classification of property as PPE or investment property

1. Bonga Ltd plans to develop an office building on erf 328 and then use the property for its own administrative purposes. Development would start in 20.5. During the development the property will be shown as "Property under construction" under "Property, plant and equipment" (IAS 16; IAS 40.09(c)). After completion the building must be accounted for as a normal PPE item.

   If it was the intention of the company to lease out the property after the development, the property (the land) must be classified from the date of purchase as an investment property (IAS 40.08(b) and (e)). After completion of the construction the property would remain an investment property. Any difference between the total cost of the property at the date of completion (i.e. the carrying amount) and the fair value at that date must be recognised as a fair value adjustment in P/L (IAS 40.65).

   If it was in the company's ordinary course of business to buy and sell property, or the construction or development of such property for such sale, the property must be classified as inventory (IAS 40.09(a)).

2. The property on erf 2001, however, is treated according to IAS 40.57(d) and .61 as owner-occupied property (PPE) up to the date of change in use (date of end of owner-occupation). Any difference at that date between the carrying amount of the property (as PPE) and its fair value is treated as a revaluation according to IAS 16. This would be the case regardless of whether the property is accounted for under the cost model or the revaluation model.

   IAS 40 requires that only one figure should be disclosed for investment property and not the different properties separately as is the case above. The way it is done here in the answer is simply for educational purposes. However, you will not be penalised if you show it separately in the exam, as long as the **total** is also given.

SUGGESTED SOLUTION QUESTION 3 (continued)

3. Deferred tax

	20.4 R	20.3 R
Office building: Land [(180 000 – 150 000) x 28% x 66,6%]	5 595	-
Office building: Building [(570 000 – 540 000) x 28% x 66,6%]	5 595	-
Residential property: Land [(250 000 – 250 000) x 28% x 66,6%]	-	-
Residential property: Building [(487 500 – 387 200) x 28%]	28 084	-
Erf 327: Land [(260 000 – 250 000) x 28% x 66,6%]	1 865	-
Erf 328 [(250 000 – 250 000) x 28% x 66,6%]	-	-
Administration building: Land [(135 000 – 120 000) x 28% x 66,6%]	-	2 797
Administration building: Building [(400 000 – 380 000) x 28% x 66,6%]	-	3 730
Deferred tax liability at end of year	41 139	6 527

OR

Accelerated tax allowances [(112 800 – 12 500) x 28%]	28 084	-
Revaluation surplus: land (20 000 x 66,6% x 28%)	3 730	-
Revaluation surplus: building [(10 000 x 28% - (10 000 x 66,6% x 28%)]	1 865	-
Fair value adjustment: land [(10 000 + 10 000) x 66,6% x 28%]	3 730	2 797
Fair value adjustment: building (20 000 x 66,6% x 28%)	3 730	3 730
Deferred tax liability at end of year	41 139	6 527

4. Profit before tax

	20.4 R	20.3 R
Profit before tax includes the following items:		
Income		
Profit on disposal of investment property (560 000 - 535 000) (note 2)	25 000	-
Rental income from investment property [(25 000 x 5) + 160 000]	285 000	180 000
Rental income from property under an operating lease	150 000	-
Expenses		
Rental paid for property under an operating lease (15 000 x 8)	(120 000)	-
Depreciation (note 1)	(15 833)	(6 667)
Direct operating expenses on investment property that generated rental income [(1 500 x 5)[1] + 20 000]	(27 500)	(25 000)
Direct operating expenses on investment property that did not generate rental income [(1 500 x 1) + 8 000][1]	(9 500)	-

LECTURER'S COMMENT

[1] Security and marketing costs are **not** costs that could be capitalised against property, plant and equipment or investment property, but are accounted for in profit or loss in the period during which they were incurred. (Also refer to calc 1.)

SUGGESTED SOLUTION QUESTION 3 (continued)

CALCULATIONS

1. Profit before tax

	R
20.4	
Given	400 000
Adjustment to capitalised costs - Randburg [(8 x 1 500) + 8 000] (see note 4)	(20 000)
	380 000

2. Deferred tax

2.1 Office building, Randburg (property, plant and equipment that became investment property)

20.3	**Carrying amount R**	**Tax base R**	**Exempt difference R**	**Temporary differences R**	**Deferred tax asset/ (liability) R**
Cost [150 000 (land) + 500 000 (building)]	650 000	-	650 000		
Depreciation (note 1)	(6 667)		(6 667)[1]		
Balance on 31 December 20.3	643 333	650 000	(6 667)	-	-
Land	150 000	150 000	-	-	-
Building	493 333	500 000	(6 667)	-	-
20.4					
Depreciation (note 1)	(3 333)	-	(3 333)		
Additions (note 1)	40 000	40 000	-		
Revaluation: land (note 1)	20 000	-	-		
Revaluation: building (note 1)	20 000	-	-		
Fair value adjustment: land (note 2)	10 000	-	-		
Fair value adjustment: building (note 2)	20 000	-	-		
Balance on 31 December 20.4 (note 2)	750 000	-	690 000	60 000	(11 190)
Land	180 000	-	150 000	30 000	(5 595)
Building	570 000	-	540 000	30 000	(5 595)

LECTURER'S COMMENT

1. On the administration building that is accounted for under the cost model, no deferred tax is provided for and any depreciation is an exempt difference. When an administration building is revalued and there is no intention to sell as is the case in this example, such an asset with a limited expected useful life is regarded as a depreciable asset. Deferred tax is accordingly provided for at the current tax rate (28% in the question) on the revaluation even when the South African Revenue Services does not grant a capital allowance on it.

SUGGESTED SOLUTION QUESTION 3 (continued)

LECTURER'S COMMENT

In this regard you should note the requirements of IAS 12.15 (c) (ii) and 20. A deferred tax liability/asset is not recognised when such a liability or asset arises due to the initial recognition of an asset or liability in a transaction which at the time of the transaction affects neither accounting profit nor taxable income (tax loss). A revaluation as is the case in this example) is, however, not an initial transaction and therefore deferred tax is provided on the difference between the carrying amount and the revalued amount, even if the carrying amount arose due to depreciation that is for tax purposes exempt (non-deductible). The deferred tax balance will realise when the asset is disposed / devalued.

2. IAS 12 presumes that the recovery of the carrying amount of investment properties carried at fair value will normally be through sale. Deferred tax will thus be provided for on 66,6% x 28% on the fair value adjustments of both land and buildings.

2.2 Administration building, Johannesburg (investment property)

20.3	**Carrying amount R**	**Tax base R**	**Exempt difference R**	**Temporary differences R**	**Deferred tax asset/ (liability) R**
Cost (120 000 + 380 000) (note 2)	500 000	-	500 000		
Fair value adjustment: land (note 2)	15 000	-			
Fair value adjustment: building (note 2)	20 000	-			
Balance on 31 December 20.3	535 000	-	500 000	35 000	(6 527)
Land	135 000	-	120 000	15 000	(2 797)
Building	400 000	-	380 000	20 000	(3 730)
20.4					
Disposal	(535 000)	-	(500 000)	(35 000)	6 527
Land	(135 000)	-	(120 000)	(15 000)	2 797
Building	(400 000)	-	(380 000)	(20 000)	3 730
	-	-	-	-	-

SUGGESTED SOLUTION QUESTION 3 (continued)

2.3 Residential property, Roodepoort (property, plant and equipment)

20.4	Carrying amount R	Tax base R	Temporary differences R	Deferred tax asset/ (liability) R
Cost (note 1) [250 000 (land)+ 500 000 (building])	750 000	750 000		
Depreciation/tax allowance (note 1) (given)	(12 500)	(112 800)		
Balance on 31 December 20.4	737 500	637 200	100 300	(28 084)
Land	250 000	250 000	-	-
Building	487 500	387 200	100 300	(28 084)

2.4 Erf 327, Randburg (investment property)

20.4	Carrying amount R	Tax base R	Temporary differences R	Deferred tax asset (liability) R
Cost	250 000	250 000		
Fair value adjustment	10 000	-		
Balance on 31 December 20.4	260 000	250 000	10 000	(1 865)

2.5 Erf 328, Randburg (property, plant and equipment)

20.4	Carrying amount R	Tax base R	Exempt differences R	Deferred tax asset (liability) R
Cost	250 000	-	250 000	-

SUGGESTED SOLUTION QUESTION 3 (continued)

2.6 Deferred tax balance and movement

	20.4 R	20.3 R
Balance beginning of year - liability	(6 527)	-
Balance end of year - liability	(41 139)	(6 527)
- revaluation: land (2.1) (20 000 x 66,6% x 28%]	(3 730)	-
- revaluation: building (2.1) (10 000 x 28%) (remaining R10 000 is an exempt difference)	(2 800)	-
- rate adjustment: gebou (2.1) [10 000 x 66,6% x 28%] – 2 800]	935	-
- fair value adjustment: land (2.1 and 2.4) (2.2) [(10 000 + 10 000) x 66,6% x 28%]; (15 000 x 66,6% x 28%)	(3 730)	(2 797)
- fair value adjustment: building (2.1) (2.2) (20 000 x 66,6% x 28%); (20 000 x 66,6% x 28%)	(3 730)	(3 730)
- depreciation (2.3) [(112 800 – 12 500) x 28%]	(28 084)	-
Deferred tax movement during year	34 612	6 527
- debit P/L in statement of profit or loss and other comprehensive income	29 017	6 527
- debit other comprehensive income in statement of profit or loss and other comprehensive income[1] (3 730 + 2 800 – 935)	5 595	-

LECTURER'S COMMENT

[1] **Journal**

	Dr R	Cr R
Other comprehensive income (gain on property revaluation)	5 595	
Deferred tax (see note 6 on revaluation surplus)		5 595

LECTURER'S COMMENT

A revalued amount is accounted for in **other comprehensive income** in the statement of profit or loss and other comprehensive income. Any deferred tax that arises from such a revaluation is accordingly accounted as a debit against the component itself or included in the total tax amount relating to all components in other comprehensive income (or in the note with only the net amount of the component within other comprehensive income) and credited against deferred tax in the SFP. It is therefore not part of the deferred tax movement through P/L.

The revaluation is neither an exempt difference to the profit before tax figure in P/L (in statement of profit or loss and other comprehensive income) as it was never included in this figure. It is therefore also not an item that should be included in the tax rate reconciliation.

SUGGESTED SOLUTION QUESTION 3 (continued)

LECTURER'S COMMENT

For all the capital gains tax calculations use 28% x 66,6% to ensure that rounding does not affect your answer. Do not round the CGT rate.

SUGGESTED SOLUTION QUESTION 4

FUTURE LTD

PART A

1. Calculation of the recoverable amount

	R
Expected selling price	800 000
Costs of disposal	(50 000)
Fair value less costs to sell	750 000
Value in use (given)	300 000

Recoverable amount is the greater of fair value less costs to sell and value in use.

	R
Therefore recoverable amount (the fair value less costs to sell)	750 000

2. Calculation of the impairment loss

	R
Carrying amount	2 800 000
Recoverable amount (calc 1)	(750 000)
Impairment loss	2 050 000

PART B

FUTURE LTD

NOTES FOR THE YEAR ENDED 28 FEBRUARY 19.8

	19.8 R	19.7 R
2. Profit before tax		
Included in profit before tax are the following:		
Depreciation - machinery	400 000	400 000
Impairment loss on machinery (part A) (included in Other expenses)	2 050 000	-

3. Impairment of asset

“Machine 2000" was impaired during the year due to the machine being physically damaged. The impairment amounted to R2 050 000. It is part of the xxx segment of the primary business operations of the company.

The recoverable amount of “Machine 2000" is its fair value less costs to sell based on its fair value by reference to an active market.

SUGGESTED SOLUTION QUESTION 4 (continued)

LECTURER'S COMMENT

Since the impairment loss is material to the financial statements IAS 36.130 requires that the following should be disclosed (it is also applicable to any reversal of impairment losses):

- the events and circumstances that led to the recognition/reversal
- the amount of the impairment loss/reversal
- the nature of the asset
- segment information
- whether the recoverable amount is based on the value in use (plus the discount rate used in the estimate) or on the fair value less costs to sell (plus the basis used to determine this, such as reference to an active market or other prices).

3. Property, plant and equipment	**19.8** **R**	**19.7** **R**
"Machine 2000"		
Carrying amount beginning of year	3 200 000	3 600 000
Gross carrying amount	4 000 000	4 000 000
Accumulated depreciation	(800 000)	(400 000)
Depreciation (4 000 000 x 10%)	(400 000)	(400 000)
Impairment loss (included in Other expenses)	(2 050 000)	-
Carrying amount end of year	750 000	3 200 000
Gross carrying amount	4 000 000	4 000 000
Accumulated depreciation and impairment	(3 250 000)[1]	(800 000)

[1] 800 000 + 400 000 + 2 050 000

SUGGESTED SOLUTION QUESTION 5

AL LTD

NOTES FOR THE YEAR ENDED 31 AUGUST 20.2

1. Accounting policy

1.1 Research costs
Research costs are recognised as an expense in the period in which it is incurred.

1.2 Internally generated intangible assets - development costs
Development costs are recognised as an expense in the year in which they are incurred, unless they meet the recognition criteria for assets in which case they are capitalised and amortised on a systematic basis so as to reflect the pattern in which the expected economic benefits are recognised.

Patents have a limited useful life and are amortised over its useful life on the basis of expected sales over the next 5 years.

1.3 Deferred tax
Deferred tax is provided on all temporary differences by using the statement of financial position approach.

2. Profit before tax
Profit before tax includes the following items:

	R
Amortisation (calc 1) (included in Cost of sales)	25 500
Impairment loss of intangible asset (patent) (included in Cost of sales)	34 500

3. Internally generated intangible asset (patent)

	R
Carrying amount at beginning of year	-
Development costs capitalised	510 000
Impairment loss (calc 1) (included in Cost of sales)	(34 500)
Amortisation (510 000/5 x 3/12) (included in Cost of sales)	(25 500)
Carrying amount at end of year	450 000
Gross carrying amount	510 000
Accumulated amortisation and impairment	(60 000)

The internally generated patent that will be used on the manufacturing plant with a carrying amount of R450 000 has a remaining amortisation period of 4 years and 9 months.

LECTURER'S COMMENT

Since the intangible asset is material to the financial statements IAS 38.122 requires that a description, the carrying amount and the remaining amortisation period of the individual intangible asset should be disclosed.

SUGGESTED SOLUTION QUESTION 5 (continued)

4. Impairment of assets

The carrying amount of the development costs associated with the patent exceeded the amount that will be recovered through the usage thereof. The impairment loss amounted to R34 500.

The recoverable amount of the development costs of the patent was determined using the value in use based on a pre-tax discount rate of 15%.

LECTURER'S COMMENT

This note could also form part of the note on

- intangible assets or
- profit before tax.

5. Income tax expense

Major components of tax expense	**R**
Current tax (calc 2)	50 400
Deferred tax (calc 3)	(8 400)
SA normal tax expense	42 000

6. Deferred tax	**R**
Intangible asset [(450 000 – 510 000) x 28%]	16 800
	16 800
OR	
Accelerated tax allowances: patent (calc 3)	16 800
Deferred tax asset at end of year	16 800

CALCULATIONS

1. Amortisation and impairment

		R
Cost		510 000
Amortisation (510 000/5 x 3/12)		(25 500)
		484 500
Test for impairment:		
recoverable amount is the higher of the:		
- value in use	R450 000	
- fair value less cost to sell	R430 000	
Therefore: value in use		(450 000)
Impairment loss		34 500

SUGGESTED SOLUTION QUESTION 5 (continued)

2. Current tax expense

	R
Profit before tax (given)	150 000
Temporary differences	60 000
Tax allowance (not yet in use)	-
Amortisation	25 500
Impairment loss	34 500
	210 000
Less: Assessed loss brought forward from prior year	(30 000)
Taxable income	180 000
Current tax (180 000 x 28%)	50 400

3. Deferred tax: statement of financial position approach

	Carrying amount R	Tax base R	Temporary difference R
Intangible assets	450 000	510 000	60 000
Deferred tax asset @ 28%			16 800
Balance at beginning of year (given: asset)			8 400
Deferred tax movement (cr statement of profit or loss and other comprehensive income)			8 400

SUGGESTED SOLUTION QUESTION 6

S-WARE LTD

a) NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.0

1. Accounting policy

1.1 Intangible assets

Licences with a limited useful life are shown at cost less accumulated amortisation and impairment losses and are amortised on the straight-line basis over the expected useful life of 20 years.

2. Intangible assets

Licence	**20.0** **R**
Carrying amount at beginning of year	2 280 000
Gross carrying amount	2 400 000
Accumulated amortisation	(120 000)
Amortisation included in other expenses (2 400 000/20)	(120 000)
Impairment loss included in other expenses (calc 3)	(194 890)
Carrying amount at end of year	1 965 110
Gross carrying amount	2 400 000
Accumulated amortisation and impairment loss	(434 890)

The licence to sell Grafic software packages has a carrying amount of R1 965 110 and a remaining amortisation period of 18 years.

3. Impairment of assets

The intangible asset (licence for the selling of Grafic software packages) was impaired during the year due to the licence also being awarded to a major competitor of S-Ware Ltd. It resulted in a reduction of the net cash inflows to the company. The impairment amounted to R194 890 and is part of the primary segment of software sales.

The recoverable amount of the asset is based on the value in use and a pre-tax discount rate of 19,44%. There was no impairment of the asset in the previous year.

LECTURER'S COMMENT

This note could also form part of the note on
- intangible assets or
- profit before tax.

SUGGESTED SOLUTION QUESTION 6 (continued)

4. Profit before tax

Included in profit before tax are the following items:

	R
Amortisation (licence) (included in Other expenses)	120 000
Impairment loss on licence (included in Other expenses)	194 890

CALCULATIONS

1. Calculation of recoverable amount

	R
Fair value less costs to sell (given)	1 500 000
Value in use	1 965 110
Recoverable amount is therefore	1 965 110

2. Calculation of carrying amount - 28/02/20.0

Cost	2 400 000
Accumulated amortisation (2 400 000/20 x 2)	(240 000)
Carrying amount - 28/02/20.0	2 160 000

3. Calculation of impairment

Carrying amount (calc 2)	2 160 000
Recoverable amount (calc 1)	(1 965 110)
Impairment loss	194 890

b) REVERSAL OF IMPAIRMENT LOSS

1. Amortisation for the year

	R
Carrying amount at 28 February 20.0	1 965 110
Amortisation is therefore (1 965 110/18 years)	109 173

2. Carrying amount at 28 February 20.2 based on original cost price (had there been no impairment loss)

Cost	2 400 000
Amortisation 1 March 19.8 - 28 February 20.2 (2 400 000/20 x 4)	(480 000)
	1 920 000

3. Reversal of impairment loss

Carrying amount at 28 February 20.2 after impairment [1 965 110 - (109 173 x 2)]	1 746 764
Less: recoverable amount limited to carrying amount if no impairment loss (calc 2)	(1 920 000)
Reversal of impairment loss	173 236

SUGGESTED SOLUTION QUESTION 7

PART A

	Dr R	Cr R
1 January 20.3		
Investment in debentures (3 500 x R190)	665 000	
Bank		665 000
Purchase of debentures		
Investment in debentures	1 000	
Bank		1 000
Recording of transaction cost		
31 December 20.3		
Investment in debentures ((665 000 + 1 000) x 12,023%)	80 073	
Interest received		80 073
Charge interest received at effective interest rate		
Bank	70 000	
Investment in debentures		70 000
Interest received for the year		
31 December 20.4		
Investment in debentures [(666 000 + (80 073 - 70 000)) x 12,023%]	81 284	
Interest received		81 284
Charge interest received at effective interest rate		
Bank	70 000	
Investment in debentures		70 000
Interest received for the year		
31 December 20.5		
Investment in debentures	82 643	
[(666 000 + (80 073 + 81 284 - 70 000 - 70 000)) x 12,023%]		
Interest received		82 643
Charge interest received at effective interest rate		
Bank	770 000	
Investment in debentures		770 000
Interest and repayment of capital received		

CALCULATION

PV	= - [(3 500 x 190) + 1 000] = -666 000
n	= 3
PMT	= [(3 500 x 200) x 10%] = 70 000
FV	= 700 000
Comp i	= 12,02%

SUGGESTED SOLUTION QUESTION 7 (continued)

Amortisation table:

	Opening balance R	Interest income (at 12,02%) R	Payment at 10% R	Difference (capital growth) R	Closing balance R
Year 1	666 000	80 074	70 000	10 074	676 074
Year 2	676 074	81 284	70 000	11 284	687 358
Year 3	687 358	82 642	70 000	12 642	700 000

PART B

The forward exchange contract (FEC) is a cash flow hedge taken out to cover a forecast transaction.

On 28 February 20.2 the transaction was still not recorded, but the FEC must nevertheless be translated at the market related forward rate available for a similar FEC for the remaining period till maturity of the original contract. The resulting profit or loss of the translation is credited or debited against other comprehensive income (cash flow hedge reserve).

The amount of the cash flow hedge reserve at **28 February 20.2** is:
£42 800 x (12,64 - 12,45) = R8 132

	Dr R	Cr R
Derivative financial instrument (FEC asset)	8 132	
Other comprehensive income (cash flow hedge reserve)		8 132

On **1 April 20.2** there is a further cash flow hedge from the year-end until the transaction date. The FEC must be translated at the market related forward rate available for a similar FEC for the remaining period till maturity of the original contract.

Derivative financial instrument (FEC asset)	5 136	
Other comprehensive income (cash flow hedge reserve) [£42 800 x (12,76 - 12,64)] = R5 136		5 136

The cumulative hedging gain (accumulated up to this point via other comprehensive income in equity)must be removed from equity and the effective portion (90%) recognised against the cost price of inventory (basis adjustment) and the ineffective portion (10%) recognised in P/L. After the transaction date (a fair value hedge) any hedging gain or loss concerning the FEC is recognised in P/L.

Inventory (SFP)	543 560	
Creditor (£42 800 x 12,70)		543 560

Account for the inventory on the transaction date

SUGGESTED SOLUTION QUESTION 7 (continued)

	Dr R	Cr R
Other comprehensive income (cash flow hedge reserve)	13 268	
Inventory (SFP)		11 941
Foreign exchange difference/profit (P/L)		1 327
(R8 132 + R5 136) OR [£42 800 x (12,76 - 12,45)] = R13 268		
(R13 268 x 90% = R11 941)		
(R13 268 x 10% = R1 327)		

On **1 May 20.2** the final transaction is journalised in one of the following ways:

	Dr R	Cr R
Foreign exchange difference /loss(P/L)	2 140	
Creditor		2 140
[£42 800 x (12,75 - 12,70)]		
Creditor (542 860 + 2 140)	545 700	
Foreign exchange difference/loss (P/L) [£42 800 x (12,76 - 12,75)]	428	
FEC asset		13 268
Bank (42 800 x 12,45)		532 860

OR

	Dr R	Cr R
Creditor	543 560	
Foreign exchange difference/loss (P/L)	2 568	
FEC asset (8 132 + 5 136)		13 268
Bank (£42 800 x 12,45)		532 860

SUGGESTED SOLUTION QUESTION 8

(a) SOUTH COAST LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.2

	Note	20.2 R
Continuing operations		
Revenue (305 500 - 59 000 - 42 000 - 3 000)		201 500
Cost of sales (185 900 - 65 000 - 42 000 - 2 900)		(76 000)
Gross profit		125 500
Other income		7 856
Other expenses [58 000(given) - (21 000 + 25 000 + 1 000)(disc. operation) + 16 000(depr.) + 4 000(depr.) + 3 000 (calc 4)]		(34 000)
Profit before tax		99 356
Income tax expense (calc 1)	2	(25 620)
Profit for the year from continuing operations		73 736
Discontinued operations		
Revenue (59 000 + 42 000 + 3 000)		104 000
Expenses [(65 000 + 42 000 + 2 900)[1] + (21 000 + 25 000 + 1 000)[2] + (7 333 (calc 2) + 9 167 (calc 3) + 917 (calc 5)[3] + 800[4] + 2 000[5] + 1 200[6] + 20 000[7])]		(198 317)
Other income (calc 2)		25 333
Loss before tax		(68 984)
Income tax benefit	2	18 195
Loss after tax		(50 789)
Loss after tax with measurement of non-current assets held for sale		(2 100)
Loss with measurement of non-current assets held for sale to fair value less costs to sell (calc 6)	2	(2 916)
Income tax benefit (calc 6)		816
Loss for the year from discontinued operations		(52 889)
Profit for the year[73 736 + (52 889)]		20 847
Total comprehensive income for the year		20 847

1 Cost of sales (given)
2 Other expenses (given)
3 Depreciation on plant, vehicle and equipment
4 Direct cost of discontinuance
5 Severance package to employees
6 Provision for direct cost of discontinuance
7 Provision for severance package to employees

SUGGESTED SOLUTION QUESTION 8 (continued)

(b) SOUTH COAST LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.2

2. Income tax expense

Major components of tax expense	**R**
Current tax (calc 1)	13 337
Continuing operations	22 353
Discontinued operations	(9 016)
Deferred tax (calc 2)	(6 637)
Continuing operations	3 266
Discontinued operations [9 086 + 817 (calc 6)]	(9 903)
SA normal tax expense	6 700

Tax rate reconciliation:	**R**
Tax at standard rate on accounting profit [(99 356 + (68 984)) - 2 916[1] x 28%]	7 687
Exempt income (33,4% of profit on plant above cost) (2 000 x 33,4% x 28%)	(187)
Non-deductible expenses (litigation) (5 000 x 28%)	1 400
Dividends received (7 856 x 28%)	(2 200)
Effective tax	6 700

[1] Loss with measurement of non-current assets held for sale to fair value less costs to sell.

3. Non-current assets held for sale

On 13 May 20.2 a decision to discontinue the surfboard operations was taken by the directors after the approval of a detailed discontinuance plan. On 15 December 20.2 a contract was entered into for the sale of the assets of the surf-board operations. It is expected that the assets of the surf-board operations will be sold for cash and that the disposal will be completed on 18 February 20.3

The non-current assets held for sale comprise:	**R**
Assets	
Truck	8 000
Equipment	6 000

An impairment loss of R2 916 was recognised on initial classification of the non-current assets as held for sale on 1 December 20.2 and this amount was included under loss after tax with measurement of non-current assets held for sale on the face of the statement of profit or loss and other comprehensive income. The non-current assets held for sale were reported in the XXX segment.

SUGGESTED SOLUTION QUESTION 8 (continued)

CALCULATIONS

1. Income tax expense

	Continuing operations R	Discontinued operations R
Profit/(loss) before tax	99 356	(68 984)
Exempt differences		
• Capital gain - plant (calc 2) (2 000 x 33,4%)	-	(668)
• Litigation settlement	-	5 000
• Dividends received	(7 856)	-
	91 500	(64 652)
Temporary differences	(11 667)	32 451
Depreciation	20 000 [1]	17 417 [2]
Tax allowance	(34 667) [3]	(22 832) [4]
Profit on sale of plant (cost price less carrying amount)(calc 2)	-	(23 333)
Tax recoupment on sale of plant (cost price less tax base)(calc 2)	-	39 999
Provision for costs on discontinuance (1 200 + 20 000)	-	21 200
Impairment loss (calc 4)	3 000	-
Taxable income/(loss)	79 833	(32 201)
Current tax @ 28%	22 353	(9 016)

[1] given: 16 000 + 4 000 = 20 000
[2] 7 333 (calc 2) + 9 167 (calc 3) + 917 (calc 5) = 17 417
[3] given: 26 667 + 8 000 = 34 667
[4] 13 332 (calc 2) + 7 500 (calc 3) + 2 000 (calc 5) = 22 832

SUGGESTED SOLUTION QUESTION 8 (continued)

2. Deferred tax: Statement of financial position approach

	Carrying amount R	Tax base R	Temporary differences R	Deferred tax (dr)/cr R
20.1				
Discontinued operations	51 000	39 833	11 167	3 127
Plant	24 000	13 333	10 667	2 987
Truck	20 000	22 500	(2 500)	(700)
Equipment	7 000	4 000	3 000	840
Continuing operations	96 000	77 333	18 667	5 227
Plant	64 000[1]	53 333[2]	10 667	2 987
Equipment	32 000[3]	24 000[4]	8 000	2 240
	147 000	117 166	29 834	8 354
20.2				
Discontinued operations	(7 200)	17 000	(24 200)	(6 776)
Truck (calc 6)	8 000	15 000	(7 000)	(1 960)
Equipment (calc 6)	6 000	2 000	4 000	1 120
Provision for costs on discontinuance	(21 200)	-	(21 200)	(5 936)
Continuing operations	73 000	42 667	30 333	8 493
Plant (calc 4)	45 000	26 667	18 333	5 133
Equipment	28 000	16 000	12 000	3 360
	65 800	59 667	6 133	1 717
Movement on statement of profit or loss and other comprehensive income (cr P/L) (8 354 - 1 717)				6 637

Movement in the deferred tax balance on continuing operations = 8 493 – 5 227 = 3 266

Movement in the deferred tax balance on discontinued operations = 3 127 + 6 776 = 9 903

[1] 80 000 - (80 000/5 x 1 year) = 64 000
[2] 80 000 - (80 000/3 x 1 year) = 53 333
[3] 40 000 - (40 000/10 x 2 years) = 32 000
[4] 40 000 - (40 000/5 x 2 years) = 24 000

SUGGESTED SOLUTION QUESTION 8 (continued)

2. Sale of plant - discontinued operation

	Accoun-ting R	Tax R
Carrying amount / tax base (01/01/20.2)	24 000	13 333
Depreciation (40 000/5 x 11/12)	(7 333)	-
Tax allowance (40 000/3)	-	(13 332)
Carrying amount/tax base	16 667	1
Selling price	42 000	42 000
Less: carrying amount	(16 667)	(1)
Profit on sale	25 333	41 999
Capital gain	2 000	2 000
Profit (40 000 - 16 667)	23 333	-
Recoupment for tax (40 000 - 1)	-	39 999
Capital gain subjected to capital gains tax (2 000 x 66,6%)	-	1 332

3. Truck - discontinued operation

Carrying amount / tax base (01/01/20.2)	20 000	22 500
Depreciation (30 000 x 33,33% x 11/12)	(9 167)	-
Tax allowance (30 000 / 4)	-	(7 500)
Carrying amount end of the year	10 833	15 000

4. Plant - continuing operations

Carrying amount before assessment for impairment	48 000
Recoverable amount	(45 000)
Impairment loss	3 000

5. Equipment - discontinued operation

Carrying amount / tax base (01/01/20.2)	7 000	4 000
Depreciation (10 000 x 10% x 11/12)	(917)	-
Tax allowance (10 000 / 5)	-	(2 000)
Carrying amount end of year	6 083	2 000

SUGGESTED SOLUTION QUESTION 8 (continued)

LECTURER'S COMMENT

- The carrying amount of the assets to be disposed of (plant, truck and equipment of the discontinued operation) is measured until the date of initial classification in accordance with IAS 16 Property, Plant and Equipment, the applicable Standard.
- The date of initial classification as held for sale for these assets is 1 December 20.2 because the criteria to qualify as held for sale as set out in IFRS 5.07 - .11 is met on that date.
- Tax allowances, however, will be written off until the assets are withdrawn from use on 31 December 20.2.

6. Non-current assets held for sale

	Carrying amount R	Contract price R	Impairment loss R
Remaining assets of discontinued operation			
31 December 20.2			
Truck	10 833	8 000	2 833
Equipment	6 083	6 000	83
	16 916	14 000	2 916
Impairment loss on non-current assets held for sale	2 916		
Deferred tax on impairment loss @ 28%	816		

LECTURER'S COMMENT

For all the capital gains tax calculations use 28% x 66,6% to ensure that rounding does not affect your answer. Do not round the CGT rate.

(c) DISCUSSION OF THE EFFECT OF THE ANNOUNCEMENT

In terms of IFRS 5.34 - restatement of prior periods - the comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate continuing and discontinued operations.

Therefore, when comparative information is presented with the 20.2 financial statements, the information should be restated to segregate the continuing (food processing) and discontinued operations (surf-board operation), since it is prepared after the surf-board operations were classified as a discontinued operation.

SUGGESTED SOLUTION QUESTION 8 (continued)

(d) DISCUSSION OF THE EFFECT ON THE FINANCIAL STATEMENTS

In terms of the definition of a discontinued operation (IFRS 5.32) it is a component of an entity that either has been disposed of or is classified as held for sale and:

- represents a major line of business or geographical area of operations;
- is part of a single co-ordinated plan to dispose of a separate major line of business or a geographical area of operations; or
- is a subsidiary acquired exclusively with a view to resale.

In this case the surf-board operation is classified as held for sale on 1 December 20.2 because the criteria to be classified as held for sale is met on that date.

The information in the financial statements should be restated to segregate the continuing and discontinued operations, because the circumstances that led to the classification of the operations as discontinued existed at year-end.

If the question had stated that on 1 February 20.3 the directors had decided and approved a detailed plan for discontinuance and an active programme to locate a buyer and complete the plan have been initiated, the following must be considered:

(1) If the criteria of IFRS 5.7-8 (criteria to classify a non-current asset (or disposal group) as held for sale) are only met after the reporting period, an entity shall in accordance with IFRS 5.12 not classify the non-current asset (or disposal group) as held for sale when the financial statements are issued.

(2) However, when the criteria of IFRS 5.7-8 are met after the reporting period date but before the authorisation of the financial statements for issue (in our example they were met on 1 February 20.3 before the financial statements were authorised for issue), the entity shall disclose in accordance with IFRS 5.12 the following information required in paragraph 41 (a), (b) and (d) in the notes:

.41 (a) a description of the non-current asset / disposal group;

.41 (b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;

.41 (d) if applicable, the segment in which the non-current asset / disposal group is presented.

SUGGESTED SOLUTION QUESTION 9

ADDO LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.2

	Notes	R
Continuing operations		
Revenue (1 000 000 - 38 200 - 42 600)		919 200
Cost of sales (470 000 - 29 000 - 30 000)		(411 000)
Gross profit		508 200
Other expenses (351 500 - 23 500 - 24 620)		(303 380)
Finance costs		(8 000)
Profit before tax		196 820
Income tax expense (calc 2)	2	(55 110)
Profit for the year from continuing operations		141 710
Discontinued operation		
Revenue (38 200 + 42 600)		80 800
Expenses [(29 000 + 30 000)[1] + (23 500 + 24 620)[2] + 4 300[3] + 3 400[4] + 1 900[5]]		(116 720)
Loss before tax		(35 920)
Income tax benefit (9 526 + 532) (calc 3)	2	10 058
Loss after tax		(25 862)
Loss after tax with measurement of disposal group		(9 360)
Loss with measurement of disposal group to fair value less cost to sell (calc. 1)	2	(13 000)
Income tax benefit (calc. 1)		3 640
Loss for the year from discontinued operations		(35 222)
Total profit for the year [141 710 + (35 222)]		106 488
Total comprehensive income for the year		106 488

[1] Cost of sales
[2] Other expenses
[3] Doubtful debt (30 000 - 25 700)
[4] Direct costs of discontinuance
[5] Provision for direct costs of discontinuance

SUGGESTED SOLUTION QUESTION 9 (continued)

ADDO LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.2

2. Income tax expense	**R**
Major components of tax expense	
Current tax	45 584
Continuing operations (calc 2)	55 110
Discontinued operations (calc 3)	(9 526)
Deferred tax	(4 172)
Discontinued operations (3 640 + 532);(calc 1 and 3)	(4 172)
SA normal tax expense	41 412

4. Disposal group

On 30 September 20.2 a decision was taken to discontinue the clothing segment which has not come up to expectations. On 15 November 20.2 a contract was entered into for the sale of a group of assets and liabilities, after a decision was taken on 30 September 20.2 to discontinue and sell the clothing operation. It is expected that the disposal group will be sold for cash and that the disposal will be completed on 1 March 20.3.

The disposal group comprises:

	R
Assets	
Property, plant and equipment	107 000
Inventory	20 000
Trade receivables	25 700
	152 700
Liabilities	
Trade payables	25 000
Provision for direct costs of discontinuance	1 900
	26 900

An impairment loss of R13 000 (before tax) was recognised on initial classification of the disposal group as held for sale and this amount was included under loss after tax with measurement of disposal group on the face of the statement of profit or loss and other comprehensive income. The disposal group was reported in the RSA segment.

SUGGESTED SOLUTION QUESTION 9 (continued)

CALCULATIONS

1. Disposal group

	R
Carrying amount of assets in disposal group on 15 November 20.2	
Property, plant and equipment	120 000
Inventory	20 000
Trade receivables (R4 300 written off because of uncertainty)(IAS 39)	25 700
Trade payables	(25 000)
Provision for direct costs of discontinuance	(1 900)
Carrying amount 15 November 20.2	138 800
Contract price (fair value less costs to sell) (107 000 + 20 000 + 25 700 - 25 000 – 1 900)	125 800
Impairment loss allocated to property (138 800 - 125 800)	13 000
Deferred tax on impairment loss (13 000 x 28%)	3 640

2. Tax: continued operations

Profit before tax = taxable income	196 820
Tax @ 28% (current)	55 110

3. Tax: discontinued operations

Current tax:	**R**
Loss before tax	(35 920)
Exempt differences	-
Temporary differences	
Provision for direct costs of discontinuance	1 900
Calculated tax loss	(34 020)
Current tax @ 28% (34 020 x 28%)	(9 526)

Deferred tax:

	Carrying amount R	**Tax base R**	**Temporary differences R**	**Deferred tax asset / (liability) @ 28% R**
Provision for direct cost of discontinuance	1 900	-	1 900	532
Balance at the beginning of the period				-
Balance at the end of the period				532
Movement for the year (dr SFP; cr P/L)				532

SUGGESTED SOLUTION QUESTION 10

SIVET LTD

(a) Journal entries

			Dr	Cr
			R	**R**
Year-end 31 December 20.2				
J1	01 August 20.2	Machinery	245 000	
		Creditor		245 000
		(25 000 x 9,80)		
J2	30 August 20.2	Bank	196 600	
		Short-term loan		196 600
		(20 000 x 9,83)		
J3	30 September 20.2	Foreign exchange difference/loss	2 250	
		Creditor		2 250
		[15 000 x (9,95 – 9,80)]		
J4	30 September 20.2	Creditor [(15 000 x 9,80) + 2 250]	149 250	
		Bank (15 000 x 9,95)		149 250
	01 October 20.2	No journal entry		
J5	01 December 20.2	Foreign exchange difference/loss	200	
		Bank		200
		[10 000 x (10,05 – 10,03)]		
J6	31 December 20.2	Foreign exchange difference/loss	2 800	
		Creditor		2 800
		[10 000 x (10,08 – 9,80)]		
J7	31 December 20.2	FEC asset	200	
		Foreign exchange difference/profit		200
		[10 000 x (10,10 – 10,12)]		
J8	31 December 20.2	Foreign exchange difference/loss	5 000	
		Short-term loan		5 000
		[20 000 x (10,08 – 9,83)]		
J9	31 December 20.2	Interest expense	3 318	
		Interest accrued		3 318
		[(9,83 + 10,08)/2 x 20 000 x 5% x 4/12]		
J10	31 December 20.2	Foreign exchange difference/loss	42	
		Interest accrued		42
		[(9,955(J9) – 10,08)/2 x 20 000 x 5% x 4/12]		
J11	31 December 20.2	Depreciation	12 250	
		Accumulated depreciation		12 250
		(245 000 x 20% x 3/12)		
J12	31 December 20.2	Income tax expense (calc 3)	61 135	
		South African Revenue Service		61 135

SUGGESTED SOLUTION QUESTION 10

			Dr R	Cr R
Year-end 31 December 20.3				
J13	31 January 20.3	Foreign exchange difference/gain (reversed)	200	
		FEC asset (reversed)		200
J14	31 January 20.3	Foreign exchange difference/loss	700	
		Creditor		700
		[10 000 x (10,15 – 10,08)]		
J15	31 January 20.3	Creditor	101 500	
		(245 000 + 2 250 - 149 250 + 2 800 + 700)		
		Foreign exchange difference/profit		500
		[10 000 x (10,10 – 10,15)]		
		Bank (10 000 x 10,10)		101 000
J16	31 August 20.3	Interest expense	6 777	
		Interest accrued		6 777
		[(10,08 + 10,25)/2 x (20 000 x 5% x 8/12]		
J17	31 August 20.3	Foreign exchange difference/loss (57 - 170) (see calc)	113	
		Interest accrued		113
		[3 318 + 42 + 6 777 - 10 250(J18)]		
		Or:		
		[(10,25 – 10,165) x 20 000 x 5% x 8/12] = 57		
		plus		
		[(10,08 – 10,25) x 20 000 x 5%] = (170)		
J18	31 August 20.3	Creditors	10 250	
		Bank (3 360 + 57 + 6 833)		10 250
J19	31 August 20.3	Foreign exchange difference/loss	3 400	
		Short-term loan		3 400
		[20 000 x (10,08 – 10,25)]		
J20	31 August 20.3	Short-term loan (201 600 + 3 400)	205 000	
		Bank (20 000 x 10,25)		205 000

(b) SIVET LTD

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.2

	Notes	R
Gross profit (given)		300 000
Other expenses (calc 2)		(78 342)
Finance costs	3	(3 318)
Profit before tax	2	218 340
Income tax expense (calc 3)		(61 135)
Profit for the year		157 205
Total comprehensive income for the year		157 205

SUGGESTED SOLUTION QUESTION 10 (continued)

SIVET LTD

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.2

	Notes	R
ASSETS		
Non-current assets		
Property, plant and equipment		1 000 750
[600 000 + 280 000 + 245 000 (J1) - 112 000 - 12 250 (J11) (calc 2)]		
Current assets		301 100
Trade receivables		50 000
Inventories		30 000
Cash and cash equivalents [24 300 + 196 600 (J2)]		220 900
FEC asset [10 000 x (10,12 – 10,10)] (J7)	5	200
Total assets		1 301 850
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		953 955
Share capital		200 000
Retained earnings (596 750 + 157 205)		753 955
Current liabilities		347 895
Trade and other payables [(42 000 + (10 000 x 10,08) + 3 360 (J9 and J10)]		146 160
Short-term borrowings (20 000 x 10,08) or [[96 600 (J2) + 5 000 (J8)]	4	201 600
Current tax payable (calc 3) (J12)		135
Total equity and liabilities		1 301 850

SIVET LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.2

1. Accounting policy

1.1 Financial instruments

The company enters into forward exchange contracts to buy specified amounts of various foreign currencies in the future at a predetermined exchange rate. The contracts are entered into in order to manage the company's exposure to fluctuations in foreign currency exchange rates on specific transactions.

SUGGESTED SOLUTION QUESTION 10 (continued)

Gains and losses arising from cash flow hedges are recognised in equity via other comprehensive income. Where a hedge of a forecasted transaction subsequently results in the recognition of a non-financial asset or liability, these associated gains or losses that were accumulated in equity are removed from equity and included in the initial cost or other carrying amount of the asset or liability.

Gains and losses arising from fair value hedges are recognised in profit or loss.

2. Profit before tax

Included in profit before tax are the following items:	**R**
Expenses	
Foreign exchange loss (calc 1) or (J3 + J5 + J6 + J7 + J8 + J10)	10 092
Depreciation (56 000 + 12 250) (calc 2)	68 250

3. Finance costs

	R
Interest on foreign currency short-term loan	3 318

4. Short-term borrowings

	R
Foreign currency loan (20 000 x 10,08)	201 600

The unsecured loan accrues interest at 5% per year and is repayable on 31 August 20.3.

The loan amount of €20 000 and the interest are not covered (20 000 x 10,08)

5. Financial instruments

Fair value
The fair values of forward exchange contracts are determined by direct reference to published price quotations in an active market and represent the amounts (using a rate quoted by a bank) that the company would receive to terminate the contracts at the reporting date, thereby taking into account the unrealised gains or losses of open contracts.

Designated fair value hedges
At year-end a forward contract served as a hedge for a trade payable (creditor) relating to the purchase of machinery.

The risk being hedged is an exchange loss due to an unfavourable movement in the exchange rate between the rand and the euro.

The fair value of the forward exchange contract at the reporting date was €20 000 or R201 600 (€20 000 x 10,08). The forward exchange contract matures on 31 January 20.3 and the forward rate is €1 = R10,10.

SUGGESTED SOLUTION QUESTION 10 (continued)

6. Financial risk management objectives and policies

Foreign currency risk is created due to the influence of exchange rate fluctuations. It is the company's policy to cover all exposure to foreign currency risk by means of forward exchange contracts. The company has exposure to fluctuations in the euro against the rand at year-end of which the total amount is covered.

CALCULATIONS

1. Foreign currency differences

1.1 Machinery

1.1.1 Loss with payment made on 30/09/20.2	**R**
Cost (€15 000 x 9,80)	147 000
Amount paid (€15 000 x 9,95)	149 250
Realised loss	2 250

1.1.2 Restatement of creditor at year-end	
Cost (€10 000 x 9,80)	98 000
Amount owed at 31/12/20.2 (€10 000 x 10,08)	100 800
Loss	2 800

1.1.3 First foreign currency contract	
Cost (€10 000 x 10,05)	100 500
Amount received from bank (€10 000 x 10,03)	100 300
Loss	200

1.1.4 Second foreign currency contract	
Cost (€10 000 x 10,10)	101 000
FEC at forward rate at year-end (€10 000 x 10,12)	101 200
Profit	200

1.2 Loan

Loan received (€20 000 x 9,83)	196 600
Creditor at year-end (€20 000 x 10,08)	201 600
Loss	5 000

SUGGESTED SOLUTION QUESTION 10 (continued)

1.3 Interest accrued

	R
Interest expense for the year (9.955(J9) x 20 000 x 5% x 4/12)	3 318
Interest accrued (10.08 x 20 000 x 5% x 4/12)	3 360
Loss	42

Summary

Loss - machinery	2 250
Loss - machinery	2 800
FEC loss - machinery	200
FEC profit - machinery	(200)
Loss - loan	5 000
Loss - interest accrued	42
Net loss at year-end	10 092

2. Other expenses

Depreciation - given	56 000
Depreciation - machinery (€25 000 x 9,80 x 20% x 3/12)	12 250
Foreign exchange differences (calc 1.3)	10 092
	78 342

3. Income tax expense and liability

Profit before tax (statement of profit or loss and other comprehensive income)	218 340
Current tax (218 340 x 28%)	61 135
SA normal tax (218 340 x 28%)	61 135

Current tax	61 135
Less: provisional tax paid	(61 000)
Payable to South African Revenue Service	135