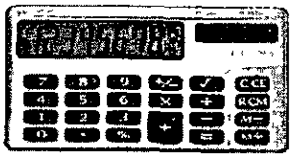
UNIVERSITY EXAMINATIONS



UNIVERSITEITSEKSAMENS

UNISA university of south africa

FAC3702

May/June 2017

DISTINCTIVE FINANCIAL REPORTING

Duration 3 Hours

100 Marks

EXAMINATION PANEL AS APPOINTED BY THE DEPARTMENT

Use of a non-programmable pocket calculator is permissible

Closed book examination.

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THIS PAPER CONSISTS OF NINE (9) PAGES.

PLEASE NOTE:

1 The paper consists of **TWO (2)** questions

2 All questions must be answered

3 All calculations must be shown

4 Ensure that you are handed the correct examination answer book (blue for accounting) by the invigilator

5 Each question attempted, **must commence on a new (separate) page**

6 **PROPOSED TIME-TABLE:** (avoid deviating from this as far as possible)

Question number	Subject	Marks	Time (minutes)
1	Property, plant and equipment, investment property, non-current assets held for sale and impairment of assets	54	97
2	Intangible assets, impairment of assets, financial instruments and the effects of changes in foreign exchange rates	46	83
	TOTAL	100	180

[TURN OVER]

QUESTION 1 (54 marks) (97 minutes)

Aladdin Candles Ltd is a candle manufacturing company The company has a 30 June financial year-end

The following is a detailed analysis of Aladdin Candles Ltd's assets

Asset	Date of acquisition	Cost R	Residual value on date of acquisition R	Useful life on date of acquisition
Property - Hatfield	1 July 2012			
Land		750 000	n/a	n/a
Building		1 750 000	nil	30 years
		2 500 000		
Property - Sandton	1 October 2014			
Land		900 000	n/a	n/a
Building		2 700 000	500 000	25 years
		3 600 000		
Property – Newlands	1 August 2015			
Land		1 200 000	n/a	n/a
Building		2 600 000	800 000	25 years
		3 800 000		
Machinery	1 August 2014	950 000	nil	10 years

Property

- **Hatfield**

Aladdin Candles Ltd carries out its manufacturing activities at its Hatfield property The land and building were revalued on 30 June 2015 to its fair value and net replacement value respectively It is company policy that revaluations will be made with sufficient regularity to ensure that carrying amounts do not differ materially from that which would be determined using fair values at the end of the reporting period On 30 June 2015 it was determined that the remaining useful life of the building remained unchanged, whilst the residual value of the building increased to R800 000 The useful life and residual value of R800 000 of the building remained unchanged during the 2016 financial year

- **Sandton**

The Sandton property is situated in the hub of the city centre and was acquired to principally earn rental income from Initially Aladdin Candles Ltd used 30% of the available floor space of this building, which is regarded as an insignificant portion, as its administrative head office On 30 June 2016 management decided to sell this property within the next year because they considered the rental income yield of the Sandton property to be too low In future Aladdin Candles Ltd will rent office space for its administrative head office The residual value and the expected useful life of the Sandton property remained unchanged throughout the period

On 30 June 2016, all the criteria to classify the Sandton property as held for sale as stipulated in *IFRS 5, Non-current Assets Held For Sale and Discontinued Operations,* were met The sale of the property is expected to be completed by 1 October 2016 for cash On 30 June 2016 the costs to sell the Sandton property were estimated to amount to R250 000

QUESTION 1 (continued)

- **Newlands**

During the current financial year Aladdin Candles Ltd decided to expand their operations to the Western Cape On 1 August 2015 Aladdin Candles Ltd acquired a warehouse to store its inventory and to distribute the candles from there to the retailers However, on 30 April 2016, Aladdin Candles Ltd vacated the warehouse in Newlands as it was not centrally located and easily accessible for the distribution of its inventory Subsequently, Aladdin Candles Ltd rented another more centrally located warehouse in Maitland and started to convert the Newlands warehouse into offices to be rented out to third parties During May 2016 costs of R550 000 were incurred for improvements to the Newlands building On 1 June 2016 the first occupants moved into the offices in Newlands

The fair values and net replacement values of the properties on the respective dates were as follows

	30 June 2015 R	30 April 2016 R	30 June 2016 R
Hatfield			
Land	860 000	-	-
Building	2 000 000	-	-
Sandton			
Land	1 050 000	-	1 100 000
Building	2 800 000	-	2 860 000
Newlands			
Land	-	1 230 000	1 230 000
Building	-	2 680 000	3 230 000

All the net replacement values and fair values of the assets were determined by an independent sworn appraiser who holds a recognised and relevant professional qualification and has recent experience in the location and category of the property being valued

Owner-occupied land and buildings are accounted for in accordance with the revaluation model On revaluation, accumulated depreciation is eliminated against the gross carrying amount of the asset It is company policy to record revaluation surpluses at the beginning of a financial year and any revaluation surplus realises through the use of the underlying asset

Investment property is accounted for in accordance with the fair value model

Depreciation on buildings is accounted for in accordance with the straight-line method over the estimated useful lives of the assets Depreciation for the current year is based on the fair values of the buildings determined at the end of the year All the properties were available for use, as intended by management, on acquisition date

Assume that land and buildings are regarded as separate classes of assets

Machinery

Aladdin Candles Ltd owns machinery that is used to manufacture the candles The machinery was available for use, as intended by management, on acquisition date The machinery has to undergo a major inspection every 3 years to comply with safety regulations On acquisition date, the total inspection costs relating to the machinery were estimated to be R95 000 On 31 January 2016, Aladdin Candles Ltd carried out the required inspection of the machinery and incurred costs of R75 000 On 30 June 2016 the fair value less costs to sell of the machinery was estimated to be R720 000 and the value in use was calculated at R700 000, using a pre-tax discount rate of 11% per annum

Machinery is accounted for in accordance with the cost model

Depreciation on machinery is accounted for in accordance with the straight-line method over the estimated useful lives of the assets

[TURN OVER]

QUESTION 1 (continued)

Taxation

The South African normal tax rate is 28% The capital gains inclusion rate is 80%

The South-African Revenue Service allows a 5% annual building allowance on the buildings according to sections 13(1) and 13*quin* of the Income Tax Act respectively, on the straight-line method, not apportioned for part of a year Improvement costs will be regarded as of a capital nature for taxation purposes

Deferred tax is provided for on all temporary differences in accordance with the statement of financial position approach There are no other items causing temporary or exempt differences except those identified in the question The company will have sufficient taxable profit in future, against which any unused tax losses can be utilised

Assume that all amounts are material

REQUIRED:

		Marks
a)	Prepare all the relevant **general journal entries** in the accounting records of Aladdin Candles Ltd for the year ended 30 June 2016, to correctly account for the reclassification of the Sandton property	5
b)	Disclose the property, plant and equipment note to the annual financial statements of Aladdin Candles Ltd as at 30 June 2016 (A total column is **not** required)	32
c)	Calculate the deferred tax balance in the statement of financial position of Aladdin Candles Ltd as at 30 June 2016 **only** relating to the land and buildings of the Hatfield and Newlands properties	14
d)	Discuss the disclosure requirements of the Sandton property in terms of *IFRS 5, Non-current Assets Held For Sale and Discontinued Operations* in the notes to the financial statements of Aladdin Candles Ltd on 30 June 2016	2
		[54]

Please note:

Your answer must comply with the requirements of International Financial Reporting Standards (IFRS)
Show the **date** of each journal entry
Journal narrations are **not** required
No abbreviations for general ledger account names can be used
Accounting policy notes are **not** required
Show all calculations
Round all amounts to the nearest Rand
Ignore any VAT and tax implications
Ignore comparative information

QUESTION 2 (46 marks) (83 minutes)

THIS QUESTION CONSISTS OF TWO INDEPENDENT PARTS

PART A (41 marks) (74 minutes)

TickTock Ltd, a company listed on the JSE Limited, manufactures and distributes watches to all the major retailers in South Africa TickTock Ltd has a 29 February financial year-end

Preference shares

On 1 March 2010 TickTock Ltd issued 10% cumulative non-redeemable preference shares of R2 000 000 The preference dividend is payable at the full discretion of TickTock Ltd

Investment – Hours Ltd

On 1 December 2015 TickTock Ltd acquired 1 000 ordinary shares in Hours Ltd, a listed company on the JSE Limited, with the intention to earn capital appreciation in the long term On this date the directors irrevocably elected to classify this investment as at fair value through other comprehensive income The shares were purchased at R7,50 per share and TickTock Ltd paid transaction costs amounting to R700 The market value of these shares on 29 February 2016 is R8,70 per share

Licence

On 1 March 2015 TickTock Ltd entered into a licence agreement with an European company to manufacture and sell the "Rush" brand of watches The licence was purchased at a cost of €45 000 and is valid for a period of 8 years All risks and rewards associated with the licence were transferred to TickTock Ltd on the agreement date Legal costs amounting to R15 500 were incurred to finalise the agreement and paid in cash on the agreement date The licence was available for use, as intended by management, on acquisition date The licence is payable in two instalments of €20 000 on 31 July 2015 and €25 000 on 31 March 2016, respectively You should assume that the time value of money related to this deferred payment, is not material

In order to hedge themselves against fluctuations in exchange rates, TickTock Ltd entered into the following forward exchange contracts (FEC's)

- On 1 March 2015, an 5 month FEC to cover the first instalment of €20 000, and
- On 31 July 2015, an 8 month FEC to cover the second instalment of €25 000

TickTock Ltd designated the FEC's as the hedging instruments and any foreign currency creditor that arises as a result of the transaction, as the hedged item The hedge complied with all the requirements of hedge accounting and the hedge was considered to be highly effective at all times during the period A hedge against foreign currency risk related to a foreign currency creditor is accounted for as a fair value hedge

The following foreign exchange rates are applicable

Date	Spot rate €1 = R	FEC rate €1 = R	FEC Period
1 March 2015	14,00	14,25	5 months
31 July 2015	14,29	14,95	8 months
29 February 2016	14,97	14,98	1 month
31 March 2016	14,99		

On 1 January 2016, a similar licence for "Rush" brand watches was issued to a competitor, resulting in a significant decrease in TickTock Ltd's sales of these watches At year-end on 29 February 2016, based on market research, the value in use of the licence was determined to be R450 000, whilst the fair value and costs to sell the licence was determined to be R480 000 and R10 000 respectively

[TURN OVER]

QUESTION 2 (PART A) (continued)

Prototype

TickTock Ltd identified the need for a smartwatch with an extended battery life and embarked on a research project to manufacture a prototype battery with an extended battery life for their smart watches

On 1 April 2015, research on the project commenced and on 1 August 2015 all the criteria for the recognition as an internally generated intangible asset was met Development of the prototype battery was completed on 31 December 2015

The following directly attributable costs, were evenly incurred during the research and development phase of the prototype battery

	R
Direct overheads	94 500
Raw materials	20 250

An engineer, earning a monthly salary of R60 000, was appointed to work full-time on the research and development of the prototype battery

On 1 January 2016, the prototype was available for use, as intended by management An estimated useful life of 5 years and a residual value of R50 000 was allocated to it

The following is an extract from the accounting policies of TickTock Ltd
- Intangible assets are accounted for in accordance with the cost model
- Amortisation is written off in accordance with the straight-line method over the assets' estimated useful lives

Assume that all amounts are material

REQUIRED:

		Marks
a)	Discuss whether the non-redeemable preference shares should be classified as a financial liability or as equity, according to the requirements of *IAS 32, Financial Instruments Presentation*	3
b)	Prepare all the general journal entries (including cash transactions) relevant to the dates indicated below, in the accounting records of TickTock Ltd, to correctly account for the shares in Hours Ltd • 1 December 2015 • 29 February 2016	5
c)	Prepare all the general journal entries (including cash transactions, **excluding** amortisation and impairment losses) relevant to the dates indicated below, in the accounting records of TickTock Ltd, to correctly account for the acquisition of the license, the hedged items and the hedging instruments • 1 March 2015 • 31 July 2015 • 29 February 2016	17½
d)	Calculate the impairment loss (if any) of the licence in the annual financial statements of TickTock Ltd at year-end on 29 February 2016	3

QUESTION 2 (PART A) (continued)

	Marks
e) Using the information in the above journals, as well as other information given, disclose the profit before tax note to the annual financial statements of TickTock Ltd for the year ended 29 February 2016	12½
	[41]
Please note Your answer must comply with the requirements of International Financial Reporting Standards (IFRS) Show the **date** of each journal entry Journal narrations are **not** required **No** abbreviations for general ledger account names can be used Accounting policy notes are **not** required Show all calculations Round all amounts to the nearest Rand **Ignore** any VAT and tax implications **Ignore** comparative information	

PART B (5 marks) (9 minutes)

THIS QUESTION MUST BE ANSWERED IN YOUR EXAMINATION ANSWER BOOK. EACH QUESTION HAS ONLY ONE CORRECT ANSWER. THE MARKS PER QUESTION ARE INDICATED IN BRACKETS AT THE END OF EACH QUESTION.

QUESTION 1:

The following information relating to a non-current asset classified as held for sale should be disclosed in the notes to the annual financial statements of a company, according to *IFRS 5, Non-current assets held for sale and discontinued operations*

a) A description of the non-current asset
b) A description of the facts and circumstances of the sale, or leading to the expected disposal
c) The expected manner and timing of the disposal
d) The gain or loss recognised on initial classification or subsequent measurement
e) The line item in the statement of profit or loss and other comprehensive income that includes the gain or loss
f) The reporting segment in which the non-current asset is presented

The **correct** answer is
1) a, b, d and e only
2) b, d, e and f only
3) a, b and c only
4) a, b, c, d, e and f
5) a, b and e only (1)

[TURN OVER]

QUESTION 2 (PART B) (continued)

QUESTION 2:

Which of the following statements relating to property, plant and equipment are correct according to *IAS 16, Property, plant and equipment*?

a) If a specific asset is accounted for according to the revaluation model and is subsequently devalued the decrease in the carrying amount must first be debited against the revaluation surplus related to that specific asset, in the other comprehensive income section in the statement of profit or loss and other comprehensive income
b) If a specific asset is accounted for according to the revaluation model and is subsequently devalued the decrease in the carrying amount must first be debited against the revaluation surplus related to that specific asset, in the profit or loss section in the statement of profit or loss and other comprehensive income
c) When property, plant and equipment items are initially measured at cost, the capitalisation of costs ceases as soon as the asset is in the condition and location necessary for it to be capable of operating in the manner intended by management
d) Depreciation on property, plant and equipment items is provided from the date on which the asset is brought into use, rather than when it is available for use
e) Depreciation on property, plant and equipment items ceases when the asset becomes temporarily idle or if it is retired from active use

The **correct** answer is
1) a only
2) a and c only
3) a, c, d and e only
4) a, c and e only
5) b, c and d only (1)

QUESTION 3:

Which of the following statements relating to investment property are correct, according to *IAS 40, Investment property*?

a) On disposal of investment property the difference between the net disposal proceeds and the carrying amount of the asset is recognised in the profit or loss section of the statement of profit or loss and other comprehensive income as a profit or loss
b) A building that is vacant but is held with the intention of letting it under an operating lease will be classified as an investment property
c) On initial recognition, investment property is measured at cost including legal services, property transfer taxes, start-up costs and initial operating losses
d) If a deferred tax liability or asset arises from investment property that is measured using the fair value model, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale
e) The existence and amounts of restrictions on the realisability of investment property should be disclosed in the annual financial statements of the entity

The **correct** answer is
1) a, b, c, d and e
2) a, c and e only
3) b only
4) d and e only
5) a, b, d and e only (1)

QUESTION 2 (PART B) (continued)

QUESTION 4·

According to *IAS 36, Impairment of assets*, which of the following statements relating to the impairment of assets are correct?

a) The value in use calculation of an asset should reflect the future cash flows estimated for the asset in its current condition, taking into account future capital expenditure that will enhance or improve the performance of the asset
b) When determining an asset's fair value, the fair value reflects the assumptions market participants would use when pricing the asset
c) The discount rate used to determine an asset's value in use is a pre-tax current market rate and should include the time value of money and a provision for the particular type of risk to which the asset in question is exposed
d) When determining an asset's fair value less costs of disposal, the costs of disposal are the incremental costs that are directly attributable to the disposal of the asset including termination benefits and costs associated with reducing or re-organising the entity as a result of the sale of the asset
e) A reversal of a previous impairment loss of an asset reflects that due to a change in circumstances the estimated service potential through sale or use of the asset has increased since the date of impairment of the asset

The **correct** answer is
1) a, b, c, d and e
2) c only
3) b, c and e only
4) b and c only
5) a and c only (1)

QUESTION 5.

Which one of the following statements relating to transfers between investment property and other asset categories is incorrect, according to *IAS 40, Investment property*?

1) For a transfer of a property from investment property, measured at fair value, to owner-occupied property, the fair value of the property on the date of change is deemed to be the cost of the latter asset
2) For a transfer of a property from inventories to investment property to be carried at fair value, the difference between the carrying amount and the fair value of the property on the date of transfer is recognised in the profit or loss section of the statement of profit or loss and other comprehensive income
3) An owner-occupied property that becomes an investment property to be carried at fair value, must be revalued in accordance with the requirements of *IAS 16, Property, plant and equipment,* at the date of transfer
4) When an entity uses the cost model to account for investment property, the carrying amount of the property does not change for transfers between the investment property and owner-occupied property
5) When an entity uses the cost model to account for investment property, the carrying amount of the property does change for transfers between the investment property and inventories (1)

[5]
[46]