FOREX – Class example

Pandora Limited (40 marks/ 48 minutes)

The abridged trial balance of Pandora Limited for the year ended 31 December 2012 is as follows:

Issued share capital	(200 000)
Retained earnings on 1 January 2012	(596 750)
Land	150 000
Buildings	450000
Machinery	280000
Accumulated depreciation on machinery	(112 000)
Trade Receivables	50 000
Inventory	30 000
Bank	24 300
Creditors (excl. SARS)	(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 2012 Pandora Limited bought new machinery from a European supplier for €25 000. The machinery was shipped free-on-board (FOB) on 1 August 2012, the date on which Pandora Limited became irrevocably party to the contract. The machinery arrived on 15 September 2012 and was put into service on 1 October 2012.

   The debt will be repaid as follows:

	€
30 September 2012	15 000
31 January 2013	10 000
	25 000

   On 1 October 2012 the company entered a two month foreign exchange contract (FEC) in respect of the debt that is payable on 31 January 2013. On 1 December 2012 this FEC was rolled forward for a further two months. This transaction has not yet been recorded in Pandora Limited's records, except for the payment to the overseas supplier on 30 September 2012 and the amount paid to the bank on 1 December 2012 with the forward roll of the FEC.

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

3. On 31 August 2012 Pandora Limited 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 2013
   - the capital is repayable on 31 August 2013.

   No forward exchange contract has been taken out on the transaction. This transaction has not yet been recorded in Pandora Limited's records.

4. The income tax rate is 28%.

5. There was no deferred tax balance on 1 January 2012 in Pandora Limited's records.

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

	Spot rate €1 = R	**Two month FEC €1 = R**
15 July 2012	9.90	
01 August 2012	9.80	
31 August 2012	9.83	
15 September 2012	8.85	
30 September 2012	9.95	9.98
01 October 2012	9.96	10.05
01 December 2012	10.03	10.10
31 December 2012	10.08	
31 January 2013	10.15	
31 August 2013	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,
    - 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 Pandora Limited's records on 31 December 2012

REQUIRED:

1. Prepare all the relevant journal entries up to and including 31 August 2013.

2. 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 Pandora Limited for the year ended 31 December 2012. Your answer must comply with the requirements of International Financial Reporting Standards