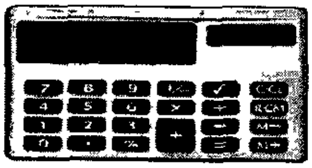
UNIVERSITY EXAMINATIONS



UNIVERSITEITSEKSAMENS

UNISA university of south africa

FAC3702

May/June 2014

DISTINCTIVE FINANCIAL REPORTING

Duration · 2 Hours

100 Marks

EXAMINERS :

FIRST	MRS M ELS MRS FF JAFFER MRS BM NEL	MS M EVANS MR MV MOKGOBINYANE
SECOND	PROF S SWART	
EXTERNAL	MS A SMIT	

Use of a non-programmable pocket calculator is permissible.

Closed book examination.

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue.

THIS PAPER CONSISTS OF SEVEN (7) 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	Intangible assets, Impairment of assets, Financial instruments and the Effects of changes in foreign exchange rates	46	55
2	Property, plant and equipment, Investment property, Non-current assets held for sale and Impairment of assets	54	65
	TOTAL	100	120

[TURN OVER]

QUESTION 1 (46 marks) (55 minutes)

THIS QUESTION CONSISTS OF TWO INDEPENDENT PARTS

PART A (36½ marks)

Healthzone Ltd is a beverage manufacturing company in Mpumalanga, South Africa The company's financial year end is 28 February The following information relates to the assets of the company

Purchased intangible asset – Pumpup licence

In order to expand its business, Healthzone Ltd negotiated with an European company to acquire a licence to manufacture and sell their energy drink, called Pumpup. The transaction was concluded on 1 June 2013 at a cost of 40 000 Euro's (€) The amount is payable in two instalments of €10 000 and €30 000, on 30 September 2013 and 31 December 2013, respectively The licence to manufacture and sell Pumpup will be for a period of 15 years, effective from 1 June 2013 The licence was available for use, as intended by management, on 1 June 2013 The licence has an estimated residual value of Rnil

In order to hedge against the fluctuations in changes in foreign exchange rates, Healthzone Ltd entered into a forward exchange contract (FEC) on 30 September 2013 for the remaining balance of €30 000, owed to the European company The cover was taken out for a period of 3 months

The following dates and exchange rates are applicable to the transaction:

Date	Spot rate € 1 = R	Forward rate for FEC € 1 = R
1 June 2013	10,89	-
30 September 2013	10,82	10,67 (3 months)
31 December 2013	10,86	-

Healthzone Ltd decided to apply hedge accounting and on 30 September 2013 designated the FEC as the hedging instrument and the foreign currency creditor that arose as a result of this transaction, as the hedged item The hedge complied with all the requirements for hedge accounting and the hedge was considered to be highly effective at all times during the period. Healthzone Ltd accounts for the hedge as a fair value hedge.

With the increased popularity of energy drinks in South Africa, more competitors of similar energy drinks entered the market, resulting in a significant decrease in the turnover of Healthzone Ltd On 28 February 2014, Healthzone Ltd determined the value in use of the Pumpup licence to be R300 000, calculated at a pre-tax discount rate of 12% per annum On 28 February 2014, the fair value less costs to sell of the licence amounted to R207 000 On this date, the remaining useful life and the residual value of the licence remained unchanged

Internally generated intangible asset – Vitamin enriched water formula

During the 2014 financial year, Healthzone Ltd embarked on a research and development project to develop a new vitamin enriched water formula

Research commenced on 1 August 2013 After completion of the research phase on 31 October 2013, the project manager and the chief financial officer of Healthzone Ltd determined that all the criteria for the recognition of an intangible asset were satisfied On 28 February 2014, the development of the formula was completed and ready for use, as intended by management The formula has an estimated useful life of 10 years No residual value was allocated to the formula

QUESTION 1 (continued)

Two full-time researchers were employed for the total duration of the research and development phase of the formula A third researcher joined the project on 1 October 2013 and was allocated to this project until the development thereof was completed A researcher earns a monthly salary of R35 000

The following costs, directly relating to the formula, were evenly incurred during the research and development phase

	R
Water and electricity	350 000
General administrative and training expenses	120 000

Additional information

1 It is the accounting policy of Healthzone Ltd to account for intangible assets according to the cost model Amortisation is provided for, using the straight-line method over the estimated useful lives of the assets

2 Assume all amounts to be material

REQUIRED:

1 Prepare all the relevant journal entries **(cash transactions included)** in the accounting records of Healthzone Ltd to correctly account for the licence, the hedged item and the hedging instrument (15)

Only journal entries relevant to the following dates should be prepared

- 1 June 2013
- 30 September 2013
- 31 December 2013

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

Note:

- **No journal entry in respect of amortisation is required.**
- **No** abbreviations for general ledger accounts may be used.
- Journal narrations are **not** required
- Show the **date** of each journal entry
- Show all calculations
- Round all amounts to the nearest Rand
- Ignore any tax implications

2 Disclose the following notes to the annual financial statements of Healthzone Ltd for the year ended 28 February 2014

2 1 Profit before tax (10)
2 2 Intangible assets (A total column is **not** required) (9½)
2 3. Impairment loss (2)

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

Note:

- Show all calculations
- Accounting policy notes are **not** required
- Round all amounts to the nearest Rand.
- Ignore comparative figures.
- Ignore any tax implications

QUESTION 1 (continued)

PART B (9½ marks)

On 1 March 2013, Investasure Ltd issued 4 900 automatically convertible debentures in an attempt to obtain additional funds for the business The debentures were issued at par with a face value of R550 per debenture Interest is payable annually in arrears at a nominal interest rate of 6,5% per annum. After a 4 year term, each debenture will automatically be converted to 600 ordinary shares at R1 each When these debentures were issued, the prevailing market interest rate for similar debt without a conversion option was 7,5% per annum

REQUIRED:

Prepare all journal entries **(cash transactions included)** to record the above transactions in the accounting records of Investasure Ltd for the year ended 28 February 2014 (9½)

Only journal entries relevant to the following dates should be prepared.

- 1 March 2013
- 28 February 2014

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

Note:

- **Indicate the date on which the journal entry is made.**
- **No** abbreviations for general ledger accounts may be used
- Journal narrations are **not** required
- **Show all the data input into your financial calculator.**
- Show all calculations
- Round all amounts to the nearest Rand
- Ignore any tax implications

QUESTION 2 (54 marks) (65 minutes)

Khona Ltd is a manufacturing company based in Polokwane, South Africa The company's financial year end is 31 October The following information relates to the assets of the company

Manufacturing property - Polokwane

Khona Ltd operates from a building that the company purchased on 1 July 2010 for R9 000 000 (Land R2 000 000, Building R7 000 000) The property was available for use, as intended by management, on acquisition date The building has an estimated useful life of 40 years with a residual value of R3 000 000

After an independent sworn appraiser performed a valuation of the property as at 31 October 2013, he provided the management of Khona Ltd with the following gross replacement values for this property

	R
Land	2 050 000
Building	7 100 000

The residual value and remaining useful life of the building remained unchanged throughout the period

Administration property – Cape Town

On 1 February 2012, Khona Ltd purchased the administration property at a cost of R8 200 000 (Land R1 900 000, Building R6 300 000) The property was available for use, as intended by management, on acquisition date The building has an estimated useful life of 30 years and a residual value of R5 000 000

On 31 January 2013, the directors of Khona Ltd decided to relocate the head office from Cape Town to Pretoria On 28 February 2013, the company vacated the administration property and relocated to Pretoria. The property was subsequently leased out and the new tenants took occupation on 1 March 2013

After an independent sworn appraiser performed valuations of this property, he provided the management of Khona Ltd with the fair values for this property as at the following dates

	28 February 2013	31 October 2013
	R	R
Land	1 960 000	2 100 000
Building	6 400 000	6 480 000

The residual value and remaining useful life of the building remained unchanged since the date of purchase

Machinery

Khona Ltd purchased a machine which was immediately available for use, as intended by management, on 1 September 2010 for R2 400 000. The machine has an estimated useful life of 650 000 units, with a residual value of R250 000

However, due to the fact that the machine did not meet its expected production capacity, the directors decided to dispose of it A detailed formal disposal plan was publicly announced and on 30 April 2013 the disposal was at a stage of completion where no realistic possibility of withdrawal existed A binding sales agreement for the machine was concluded and management expects the sale to be completed on 20 December 2013 The machine will be sold for cash

QUESTION 2 (continued)

From acquisition date until 31 October 2012, the machine had produced a total of 185 000 units During the current financial year until 30 April 2013, the machine had produced 70 000 units On 30 April 2013 the machine's fair value less costs to sell, was determined to be R1 200 000

On 31 October 2013, the fair value less costs to sell of the machine increased to R1 300 000 due to an unprecedented demand for this type of machinery.

Additional information

1 It is the accounting policy of Khona Ltd to account for owner-occupied land and buildings using the revaluation model and to account for machinery using the cost model On revaluation, the accumulated depreciation is eliminated against the gross carrying amount of the asset It is the policy of the company to realise any revaluation surplus upon disposal of the underlying asset.

2 It is the accounting policy of Khona Ltd to account for investment property using the fair value model The carrying amount of the investment property will be recovered through sale

3 Depreciation on buildings is provided for according to the straight-line method over the estimated useful lives of the assets and is calculated on the most recent revalued amount Depreciation on machinery is provided for according to the units of production method.

4 All the gross replacement values and fair values of the properties were determined by an independent sworn appraiser The values provided were determined with reference to current market prices of similar properties in the same location and condition.

5 The South African normal tax rate is 28% and 66,6% of capital gains are taxable

6 The South African Revenue Services allows the following capital allowances
- A building allowance on manufacturing buildings over 20 years according to the straight-line method, not proportioned for part of the year
- A tax allowance on machinery over 5 years according to the straight-line method, not proportioned for part of the year
- No tax allowance on administration buildings

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

8 Assume that land and buildings are regarded as separate classes of assets and that all amounts are material

REQUIRED:

1 Disclose the following notes to the annual financial statements of Khona Ltd for the year ended 31 October 2013

1 1. Property, plant and equipment (A total column is **not** required) (30)
1 2 Investment property (5)
1 3 Non-current assets held for sale (5)

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

Note:
- Accounting policy notes are **not** required
- Show all calculations
- Round all amounts to the nearest Rand
- Ignore comparative information
- Ignore any VAT implications

QUESTION 2 (continued)

2 Calculate the deferred tax balance to be included in the statement of financial position of Khona Ltd on 31 October 2013, using **only** the statement of financial position approach Indicate if the balance is a deferred tax asset or a deferred tax liability (14)

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

Note:

- Show all calculations
- Round all amounts to the nearest Rand