Tutorial Letter 103/3/2015

General Financial Reporting

FAC3701

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 e-mail address and ensure you have regular access to the myUnisa module site for FAC3701 as well as your group site.

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1. INTRODUCTION

Dear Student,

Attached please find additional questions with their suggested solutions. We suggest that you answer these questions under exam conditions. Once you have answered the question, you should then compare your answer to the suggested solution. **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 not of a similar standard to the exam questions, as the questions are not fully integrated.

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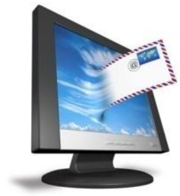

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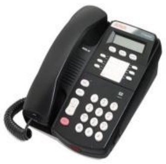

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3. ADDITIONAL QUESTIONS

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Ignore the implications of capital gains and dividend tax.

QUESTION 1 (32 marks)(38 minutes)

The following information is an extract from the statement of profit or loss and other comprehensive income and notes of Kanton Ltd for the financial year ended 31 December 20.1:

	R
Profit before tax	120 000
Profit before tax includes the following items:	
Income	
Profit on sale of motor vehicle	25 000
Dividends received	40 000
Expenses	
Provision for warranty costs	50 000
Interest and penalties on the late payment of Value-added Tax	15 000
Depreciation – plant and equipment	20 000
Depreciation – motor vehicles	30 000

Additional information

1. The following information regarding the property, plant and equipment of Kanton Ltd is an extract from the asset register **after** the recording of all the asset transactions for the year:

	Cost 1/01/20.1 R	Carrying amount 31/12/20.1 R	Depreciation rate	Tax base 31/12/20.1 R	Tax allowance
Plant and equipment	200 000	140 000	10% straight-line	80 000	5 years
Motor vehicles	120 000	20 000	25% straight-line	32 000	5 years

Included in the cost on 1 January 20.1 is a motor vehicle with a cost price of R40 000 which was sold on 31 December 20.1 for R35 000. The carrying amount and tax base of the motor vehicle at the date of the sale was R10 000 and R16 000 respectively. No other property, plant and equipment were bought or sold during the current and prior financial year.

2. No provision was made for warranty costs in 20.0. The SA Revenue Service will allow the warranty costs as a deduction for tax purposes when these costs are actually incurred.

3. Deferred tax is provided for on all temporary differences according to the statement of financial position approach. The deferred tax account reflected a credit balance of R7 840 on 31 December 20.0. The company will have sufficient taxable profit in future against which any unused tax losses can be utilised. There are no other items causing temporary or exempt differences except those identified in the question.

4. The SA normal tax rate was 28% for both the 20.0 and 20.1 financial years.

REQUIRED:

a) Calculate the current tax expense in the statement of profit or loss and other comprehensive income of Kanton Ltd for the year ended 31 December 20.1. (9)

b) Calculate the deferred tax balance of Kanton Ltd for the year ended 31 December 20.1, by using the statement of financial position approach. List all the temporary differences and indicate next to every temporary difference if it results in a deferred tax asset or a deferred tax liability. (6)

<u>QUESTION 1</u> (continued)

	c) Prepare the journal entry for the deferred tax movement in the statement of profit or loss and other comprehensive income of Kanton Ltd for the year ended 31 December 20.1. (3) d) Prepare only the relevant tax and deferred tax notes in the annual financial statements of Kanton Ltd for the year ended 31 December 20.1. Your answer must comply with the requirements of the *International Financial Reporting Standards (IFRSs)*. Ignore comparative figures and accounting policy notes. (14)

<u>QUESTION 2</u> (23 marks)(28 minutes)

The following information relates to Frest Ltd, a manufacturer of freezers, for the financial year ended 30 June 20.1:

1. Profit before tax for the year amounted to R495 000.

2. Included in profit before tax is dividends received of R25 000.

3. Included in the profit before tax are the following non deductible/taxable items according to the SA Revenue Service:

	R
Donations paid	2 000
Incentive allowance received	16 000

4. On 2 July 20.0 Frest Ltd bought new equipment for R205 000. Equipment is depreciated according to the straight-line method over 5 years. The depreciation charge for the current year is included in profit before tax. The SA Revenue Service allows a tax allowance on equipment over 4 years.

5. On 1 July 20.0, equipment was destroyed by a fire as a result of lightning. The profit realised on this equipment is included in the profit before tax. Information regarding this equipment is as follows:

	R
Insurance claim received	125 000
Cost of equipment	160 000
Carrying amount at 1 July 20.0	96 000
Tax base on 1 July 20.0	80 000

6. The accounts receivable balance at year-end consisted of the following:

	20.1 R	20.0 R
Total amount outstanding	102 000	97 000
Allowance for credit losses	(14 000)	(6 800)
	88 000	90 200

The SA Revenue Service allows only 25% of the allowance for credit losses as a tax deduction.

7. The company sells freezers with a two year warranty. The company provides for warranty costs in its annual financial statements. This provision is not deductible for tax purposes, but the actual warranty costs paid are deductible. The balance of the provision for warranty costs in the statement of financial position of Frest Ltd on 30 June 20.1 and 30 June 20.0 amounted to R32 000 and R40 000 respectively.

   Actual warranties paid during the current year amounted to R36 000 and was debited against the provision for warranty costs.

QUESTION 2 (continued)

8. The deferred tax asset balance on 30 June 20.0 amounted to R8 148. Deferred tax is provided for on all temporary differences according to the statement of financial position approach. There are no other temporary differences except those mentioned in the question. There is certainty beyond any reasonable doubt that there will be sufficient future taxable profit.

9. The SA normal tax rate was 28% for both the 20.0 and 20.1 financial years.

REQUIRED:

a) Calculate the current tax expense in the statement of profit or loss and other comprehensive income of Frest Ltd for the year ended 30 June 20.1. (12)

b) Calculate the deferred tax balance in the statement of financial position of Frest Ltd for the year ended 30 June 20.1, by using the statement of financial position approach. List all the temporary differences and indicate next to each temporary difference whether it results in a deferred tax asset or a deferred tax liability. (8)

c) Prepare the journal entry for the deferred tax movement in the statement of profit or loss and other comprehensive income of Frest Ltd for the year ended 30 June 20.1. (3)

QUESTION 3 (22 marks)(26 minutes)

The accountant of Muan Ltd prepared the following current and deferred tax calculations for the year ended 31 March 20.8:

1. Current tax calculation

	R
Profit before tax (per statement of profit or loss and other comprehensive income)	430 000
Depreciation – plant	120 000
Depreciation – motor vehicles	43 000
Tax allowance – plant	(160 000)
Tax allowance – motor vehicles	(27 520)
Fines	5 000
Department of Trade and Industry claim received from government (not taxable)	(68 000)
Prepaid insurance	(32 000)
Taxable income	310 480
Current tax @ 28%	86 934

2. Deferred tax calculation

	Carrying amount	**Tax base**	**Temporary difference**	**Deferred tax (asset)/ liability @ 28%**
31 March 20.8	**R**	**R**	**R**	**R**
Plant	560 000	480 000	80 000	22 400
Motor vehicles	86 000	110 080	(24 080)	(6 742)
Prepaid insurance	32 000	-	32 000	8 960
	678 000	590 080	87 920	24 618
31 March 20.7				
Plant	680 000	640 000	40 000	11 600
Motor vehicles	129 000	137 600	(8 600)	(2 494)
	809 000	777 600	31 400	9 106

QUESTION 3 (continued)

3. The tax rate changed from 29% in 20.7 to 28% for 20.8.

4. You can accept that the above calculations prepared by the accountant are correct.

5. Deferred tax is provided for on all temporary differences according to the comprehensive basis using statement of financial position approach.

REQUIRED:

Prepare all the relevant notes applicable to current tax and deferred tax in the annual financial statements of Muan Ltd for the year ended 31 March 20.8. Your answer must comply with the requirements of the *International Financial Reporting Standards (IFRSs*).

Ignore comparative figures and accounting policy notes.

(All calculations are to be done to the nearest rand.)

QUESTION 4 (22 marks)(26 minutes)

The following represents the trial balance of Aroma Ltd for the year ended 31 December 20.8:

	Debit R	**Credit R**
Ordinary issued share capital		100 000
Retained earnings (1 January 20.8)		800 000
Long term borrowing		546 100
Bank overdraft		51 380
Trade payables		150 000
Deferred tax liability (1 January 20.8)		40 020
South African Revenue Service		14 000
Profit before tax		455 500
Land at cost (owner-occupied)	300 000	
Building at carrying amount (owner-occupied)	480 000	
Plant and machinery at carrying amount (20.7 – R1 094 000)	998 000	
Prepaid expenses – insurance	25 000	
Investment in unlisted companies	200 000	
Trade receivables	154 000	
	2 157 000	2 157 000

Additional information

1. Depreciation and tax allowance on plant and machinery amounted to R96 000 and R108 000 respectively. The profit before tax as shown in the trial balance already includes depreciation of buildings and plant and machinery. The tax base of the plant and machinery at 31 December 20.8 amounted to R818 000 and at 31 December 20.7 to R926 000.

2. Aroma Ltd depreciates its building at R50 000 per annum, whilst no tax allowance on the building is allowed for tax purposes.

3. The company made the following allowance for credit losses:

	R
31 December 20.7	40 000
31 December 20.8	50 000

QUESTION 4 (continued)

Only 25% of the allowance for credit losses is allowed as a deduction for tax purposes. Actual credit losses are written off directly to the statement of profit or loss and other comprehensive income and not against the allowance for credit losses.

4. The deferred tax balance on 1 January 20.8 arose as a result of the taxable temporary difference on plant and machinery and the deductible temporary difference on the allowance for credit losses.

5. The long-term borrowing is a mortgage bond registered over the land and buildings. The loan bears interest at a nominal rate of 18% per annum and is repayable in monthly instalments of R8 321 each.

6. Included in profit before tax are the following items:

	R
Revenue	1 500 000
Dividends received	30 000
Cost of sales	750 000
Fines paid	2 000
Interest paid	110 000
Increase in allowance for credit losses	10 000
Credit losses written off	7 500

7. Provision should still be made for current and deferred tax. The tax rate was 29% for the year ended 31 December 20.7 and 28% for the year ended 31 December 20.8.

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

REQUIRED:

a) Calculate the current tax expense of Aroma Ltd for the year ended 31 December 20.8. (8)

b) Calculate and prepare the journal entry for the deferred tax movement (including the rate adjustment) in the statement of profit or loss and other comprehensive income of Aroma Ltd for the year ended 31 December 20.8. (11)

c) Prepare the note in respect of the deferred tax liability or asset in the annual financial statements of Aroma Ltd for the year ended 31 December 20.8. Your answer must comply with the requirements of the *International Financial Reporting Standards (IFRSs)*. (3)

QUESTION 5 (19 marks)(23 minutes)

The accountant of Kannabas Ltd has prepared the following draft statement of profit or loss and other comprehensive income and extract from the statement of changes in equity for the year ended 30 September 20.2:

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 20.2

	20.2	**20.1**
	R	**R**
Profit before tax	400 000	370 000
Income tax expense	(112 000)	(103 600)
Profit for the year	288 000	266 400
Total comprehensive income for the year	288 000	266 400

<u>QUESTION 5</u> (continued)

EXTRACT FROM STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 SEPTEMBER 20.2

	Retained earnings R
Balance at 1 October 20.0	1 440 000
Changes in equity for 20.1	
Total comprehensive income for the year	266 400
Dividends paid	(150 000)
Balance at 30 September 20.1	1 556 400
Changes in equity for 20.2	
Total comprehensive income for the year	288 000
Balance at 30 September 20.2	1 844 400

At the final finance meeting for the current year, it was discovered that VAT was not claimed back on an expense which was included with other expenses for the year ended 30 September 20.1. The effect thereof is considered to be material on the financial statements and the following journal entry was prepared by the accountant to correct the error of the prior year:

	Debit R	Credit R
Debtor – VAT refund	58 800	
Other expenses		58 800
Being the VAT claimable from SA Revenue Service		

You can assume that the journal prepared by the accountant is correct. This journal has not yet been recorded in the above statement of profit or loss and other comprehensive income and extract of the statement of changes in equity. The SA normal tax effect of the abovementioned journal has also not been calculated and recorded yet.

The SA normal tax rate has been 28% for the past three years.

The SA Revenue Service has not yet assessed the 20.1 taxable income of Kannabas Ltd and agreed to base the 20.1 assessment on the revised financial statements.

REQUIRED:

Prepare the statement of profit or loss and other comprehensive income, the retained earnings section of the statement of changes in equity as well as the note relevant to the error of Kannabas Ltd for the year ended 30 September 20.2. Your answer must comply with the requirements of the *International Financial Reporting Standards (IFRSs).*

Comparative figures are required. Accounting policy notes are not required.

<u>QUESTION 6</u> (34 marks)(41 minutes)

The following information of Stockit Ltd, for the financial year ended 30 June 20.3, is presented to you:

1. After the draft financial statements for the year ended 30 June 20.3 had been prepared, the directors of the company decided to value the inventory according to the first-in, first-out method, instead of the last-in, first-out method as previously done, in order to comply with the accounting statement dealing with inventory valuation which disallows the last-in, first-out method.

2. Profit before tax for the year ended 30 June 20.3 amounted to R4 476 000 (20.2 – R2 040 000) before taking into account the effect of the change in accounting policy.

QUESTION 6 (continued)

3. Retained earnings at 30 June 20.1 amounted to R2 990 000.

4. The tax rate has remained unchanged at 28% for the past 5 years.

5. The company provides for deferred tax on all temporary differences using the statement of financial position approach. The company had no taxable or deductible temporary differences since incorporation.

6. Up until 30 June 20.3 inventory was valued according to the last-in, first-out method. This method was also applied in the draft financial statements for the year ended 30 June 20.3.

7. A summary of closing inventory on hand at 30 June is as follows:

	20.1	**20.2**	**20.3**
	R	**R**	**R**
According to the last-in, first-out method	430 000	880 400	887 000
According to the first-in, first-out method	560 000	1 039 000	1 081 000

8. The previous years' tax assessments will **not be reopened** by the SA Revenue Service, but the new policy of inventory valuation **will be allowed** for tax purposes.

REQUIRED:

Prepare the statement of profit or loss and other comprehensive income, only the retained earnings section of the statement of changes in equity as well as all the relevant notes of Stockit Ltd for the year ended 30 June 20.3, applying the new method of inventory valuation. Your answer must comply with the requirements of the *International Financial Reporting Standards (IFRSs)*.

Comparative figures are required.
No accounting policy notes are required.
No tax rate reconciliation and deferred tax note are required.

QUESTION 7 (23 marks)(28 minutes)

1. Solution Ltd is a retailer of computer hardware, incorporated on 1 November 20.0. On this date Solution Ltd acquired the necessary equipment to commence its business operations.

2. After the annual financial statements for the year ended 30 April 20.4 had been prepared, the directors of Solution Ltd decided to change the estimated residual value of its equipment from Rnil to R25 000 to reflect the increase in the standard of performance of its equipment. Details of the equipment at 30 April 20.3 are as follows:

	R
Cost	500 000
Accumulated depreciation	(250 000)
Carrying amount	250 000

No other equipment has been purchased or disposed of since Solution Ltd commenced its business operations.

<u>QUESTION 7</u> (continued)

3. It is the company's policy to depreciate equipment over its expected useful life of five years according to the straight-line method. The SA Revenue Service allows a tax allowance at 20% per annum according to the reducing balance method.

4. During the final audit of the annual financial statements for the year ended 30 April 20.4 the auditors of Solution Ltd determined that R25 000 of the accounts receivable on 30 April 20.4 was not recoverable. The SA Revenue Service has indicated that they will allow this credit loss as a deduction. The amount of the credit loss is significant.

5. The profit before tax of Solution Ltd for the years ended 30 April 20.3 and 30 April 20.4 amounted to R660 000 and R620 000 respectively, before providing for depreciation and the abovemen-tioned items.

6. Solution Ltd proposed a dividend of R17 500 on 31 May 20.4 to all shareholders registered at year-end, 30 April 20.4.

7. After the board of directors of Solution Ltd authorised the annual financial statements for the year ended 30 April 20.4 on 30 June 20.4, it was made available to the shareholders.

8. Deferred tax is provided on all temporary differences according to the statement of financial position approach. There are no other temporary differences except those mentioned in the question. Taxable profit will probably be available in future against which deductible temporary differences can be utilised.

9. Assume a tax rate of 28%.

REQUIRED:

Prepare the statement of profit or loss and other comprehensive income and only the notes to the statement of profit or loss and other comprehensive income of Solution Ltd for the year ended 30 April 20.4. Your answer must comply with the requirements of the *International Financial Reporting Standards (IFRSs)*.

Accounting policy notes are not required. Comparative figures are required.

<u>QUESTION 8</u> (28 marks)(34 minutes)

Tik-Tak Ltd is a manufacturer of electrical equipment. The company's year-end is 31 December 20.4 and the following came to your attention before the financial statements were finalised for authorisation on 16 February 20.5:

1. The market value of a listed investment decreased in January 20.5 to R500 000. Investments are stated at market value. Assume that the company does not speculate with shares.

2. A debtor with an outstanding balance of R51 700 on 31 December 20.4, was declared insolvent and placed under liquidation on 16 January 20.5. The liquidator indicated that creditors would receive 30 cents in the rand. No allowance for credit losses was made at reporting date.

3. On 5 January 20.5 the directors declared a dividend of 10 cents per share for the year ended 31 December 20.4. There are 100 000 issued ordinary shares.

4. During January 20.5 inventory with a value of R16 000 was destroyed when a store was burnt down during a political uproar.

Assume a tax rate of 28%, that all amounts are material and that the company is a going concern.

QUESTION 8 (continued)

REQUIRED:

a) Define events occurring after the reporting period according to *IAS 10*. (6)

b) In each of the above events:

(i) discuss in brief how the event will affect assets and liabilities in the financial statements i.e. must the assets and/or liabilities be adjusted or not (8)

(ii) prepare an extract from the financial statements for the year ended 31 December 20.4 in which the discussion in (i) is disclosed in accordance with *International Financial Reporting Standards (IFRSs*) (14)

QUESTION 9 (20 marks)(24 minutes)

The financial statements of Penari Ltd are being finalised for the year ended 31 March 20.2. Penari Ltd would like to present the financial statements to the board of directors for approval for issuance on 10 June 20.2. Uncertainty still exists on the following matters:

1. Penari Ltd determined during May 20.2 that a debtor, IOU Ltd, which owes an amount of R20 000 to Penari Ltd at 31 March 20.2, is currently experiencing financial difficulties and will probably not be able to settle its debt. After further investigation it came to light that the problem has already existed for the past six months, but as Penari Ltd was unaware of this, the company continued granting credit to IOU Ltd. The result is that an amount of R35 000 was owed by IOU Ltd at 31 May 20.2.

2. Due to a cloud burst during the first week in April 20.2 the basement level of Penari Ltd's premises was flooded, resulting in the total destruction of the inventory stored there. The cost of the inventory amounting to R75 000 is included in the inventory figure in the financial statements at 31 March 20.2.

3. A claim amounting to R150 000 was instituted against Penari Ltd on 1 March 20.2 in terms of a product guarantee given by Penari Ltd on its products. On 10 June 20.2 it is still not certain if the claim will be successful and the extent of the costs is also uncertain.

4. Penari Ltd has a debtor, Dot Ltd which owes Penari Ltd R55 000 at 31 March 20.2. During April 20.2 Dot Ltd's premises were destroyed by a fire and all the assets as well as the accounting records were destroyed. Dot Ltd was not insured. However, during April 20.2 the directors of Dot Ltd negotiated with its holding company to settle the debts of Dot Ltd. Dot Ltd is not certain if these debts will be settled. At the time of the fire the outstanding amount according to Penari Ltd's records was R64 000.

5. On 31 March 20.2 Penari Ltd had 800 "Item 4" units on hand at a cost of R16 000. During April 20.2 Penari Ltd determined that half of the "Item 4" inventory items on hand at 31 March 20.2 had a defect due to a manufacturing error resulting from a problem encountered with Machine 1. The defective items can be sold for R5 each and the costs to repair the machine will be R15 000.

REQUIRED:

a) State, in each of the above cases, whether an adjusting or non-adjusting event occurred. (5)

b) Briefly discuss how the event will affect the financial statements of Penari Ltd for the year ended 31 March 20.2, according to the requirements of the *International Financial Reporting Standards (IFRSs)*. Give reasons for your answers. (15)

<u>QUESTION 10</u> (25 marks)(30 minutes)

The following information is applicable to Speedwash Ltd, a dealer in washing machines and dryers, for the year ended 30 June 20.14.

1. Speedwash Ltd sells deluxe washing machines to customers at cost plus 50%. The total cost price of the twenty (20) deluxe washing machines sold during June 20.14 amounted to R176 000. Control of the deluxe washing machines is transferred when payment is received. Speedwash Ltd's customary business practice is to allow a customer to return any deluxe washing machines within 30 days and receive a full refund if they are not fully satisfied with the use of the deluxe washing machines. Speedwash Ltd uses the expected value method and estimates that based on experience and industry norms 95 percent of the deluxe washing machines will not be returned. The customer is responsible for the cost of returning the deluxe washing machines and Speedwash Ltd sells returned deluxe washing machines at a profit.

2. Speedwash Ltd also arranges to provide domestic washing machines to local customers for a foreign company at the agreed upon price of R9 500 each. Speedwash Ltd sells the domestic washing machines on behalf of the foreign company, receives the money on behalf of the foreign company and is entitled to 15% commission thereon. In the case of bad debts, Speedwash Ltd is not exposed to credit risk for the amount receivable from customers of the foreign company. One hundred (100) domestic washing machines were received from the foreign company for sale to local customers during the current financial year. At year end on 30 June 20.14 90 domestic washing machines were sold and delivered for cash to local customers of the foreign company.

3. On 1 June 20.14 Speedwash Ltd announced their new 3 year warranty programme in respect of commercial dryers sold. Speedwash Ltd transfers control of the commercial dryers once delivery of the commercial dryers is made. All commercial dryers including a 3 year warranty can be sold from 1 June 20.14 at a total selling price of R20 000 each. Customers can also purchase commercial dryers without warranty for R18 750 each. The stand-alone selling price of a warranty contract is R2 500 each. Since the programme was initiated in June 20.14, the company sold two (2) commercial dryers with the warranty programme.

REQUIRED:

Discuss, with reasons, the recognition and measurement of revenue for each of the abovementioned cases for the year ended 30 June 20.14 in order to comply with the requirements of *IFRS 15 – Revenue from Contracts with Customers* and the application guidance of *Appendix B*. Structure your answer for each of the abovementioned cases as follows:

a) Identify the performance obligations in the contract.
b) Determine the transaction price and allocate the transaction price to the identified performance obligations.
c) Indicate what amounts should be recognised as revenue from contracts with customers for the financial year ending 30 June 20.14.

Mark allocation:

Deluxe washing machines	(7½)
Domestic washing machines	(6½)
Commercial dryers	(11)

QUESTION 11 **(10 marks)(12 minutes)**

Gracoo Ltd entered into the following transactions during the year ended 28 February 20.14:

1. On 1 March 20.13 Gracoo Ltd sold goods to the value of R500 000 to Bunnee Ltd in a consignment arrangement. On 28 February 20.14, Bunnee Ltd had already sold and delivered 80% at a profit of 10% to its customers.

2. On 1 February 20.13, Gracoo Ltd received R75 000 (the selling price) for goods ordered that were delivered on 30 March 20.13.

3. On 1 February 20.14, Gracoo Ltd received R100 000 (the selling price) from a major client for goods that must still be manufactured and delivered on 1 April 20.14.

4. On 30 June 20.13, Gracoo Ltd entered into an exchange transaction with one of its competitors, KindHearts Ltd in terms of which Gracoo Ltd gave KindHearts Ltd 15 prams in exchange for 20 cots for selling in Gracoo Ltd's shop. Gracoo Ltd usually sells prams for R3 600 each and KindHearts Ltd sells cots for R2 750 each, which is considered a reasonable estimate of the fair values of the prams and cots respectively. On the same date Gracoo Ltd entered into an exchange transaction with a new online children's boutique TinyTots Ltd in terms of which Gracoo Ltd gave TinyTots Ltd 2 prams in exchange for 35 vintage inspired couture dresses. TinyTots Ltd sells these dresses for R220 each, however due to the exclusivity of this range of dresses this selling price is not considered a reasonable estimate of the fair value of the vintage inspired couture dresses.

5. On 15 August 20.13 Gracoo Ltd entered into an agreement with Small-B Ltd in terms of which Small-B Ltd must annually pay royalties to Gracoo Ltd, based on the number of Gracoo prams being sold. The agreement came into effect on 1 September 20.13. According to the agreement R100 per pram must be paid to Gracoo Ltd. At year end on 28 February 20.14 Small-B Ltd sold 500 Gracoo prams.

6. On 30 June 20.13, goods to the value of R3 000 were sold on a lay-away arrangement. On this date, R1 000 was received. On 22 February 20.14, another R1 000 was received. The goods are on hand, but will only be delivered to the customer once the final payment has been received.

REQUIRED:

Calculate the profit before tax of Gracoo Ltd for the year ended 28 February 20.14, taking into account all the above transactions. Assume that the profit before tax amounted to R1 400 000 before taking the above transactions into account. Assume that the cost of sales of the above transactions had already been correctly taken into account in determining the profit before tax. (10)

QUESTION 12 **(25 marks)(30 minutes)**

4x4View Ltd is a manufacturer and retailer of exclusive caravans and trailers. 4x4View Ltd also sells various 4x4 accessories and products directly to the public and through a network of distributors.

1. During the year ended 28 February 20.14, 85 caravans were sold at a selling price of R125 400 each, inclusive of value added tax of 14%. The following information relates to the sale of these caravans:

	R
Sales received in cash	10 408 200
Sales outstanding at year end	250 800

QUESTION 12 (continued)

On 25 February 20.14, two (2) caravans with a total selling price of R250 800 (including 14% VAT) were sold to Mr. Wild. Mr. Wild paid for these caravans on 28 March 20.14 and the caravans were transferred in the name of Mr. Wild. Mr. Wild is responsible for both the maintenance and the insurance of the caravans from the date legal title is transferred. The other caravans sold for cash have already been transferred in the names of the buyers at year end on 28 February 20.14.

2. 4x4View Ltd undertakes 4x4 guided adventure tours for both local and international tourists. The duration of the guided adventure tours ranges between two and four weeks. Game park bookings and conservation fees are paid one month before the guided adventure tour starts. The following details relate to the guided adventure tours starting during February 20.14 and March 20.14:

	R
Tour fees received in cash for a 4 week guided tour starting 15 February 20.14	80 000
Transaction price allocated to game park bookings and conservation fees	25 000
Transaction price allocated to guided tour	55 000
Tour fees received in cash for a 3 week guided tour starting 15 March 20.14	70 000
Transaction price allocated to game park bookings and conservation fees	20 000
Transaction price allocated to guided tour	50 000

3. 4x4View Ltd sells 4x4 accessories on a consignment basis through a network of various distributors. All consignment sales are made at a gross profit of 20% on selling price. The following details relate to these 4x4 accessories:

	R
4x4 Accessories at cost, delivered on consignment to various distributors during the current year	45 000
4x4 Accessories on consignment not yet sold at cost – 28 February 20.14	14 000

4. On 15 January 20.14 a customer, FarOut Ltd, placed an order for 500 t-shirts and immediately paid an amount of R10 000 as final settlement for the order. 4x4View Ltd placed an order for these t-shirts at their supplier on 17 January 20.14, but the supplier will deliver the ordered t-shirts directly to FarOut Ltd on 3 March 20.14.

5. On 1 September 20.13, 4x4View Ltd sold five (5) trailers with a cash selling price of R88 500 (excluding VAT) each to Mr. Mild for use in his business. Mr. Mild is an entrepreneur who recently started a rental company and negotiated the following payment terms with 4x4View Ltd:

Deposit paid in cash on 1 September 20.13	R44 250,00
4 biannual instalments payable in arrears	R117 574,60
Nominal interest rate	14%

The following is the repayment schedule, which you can assume to be correct:

Date	Instalment R	Capital R	Interest R	Balance outstanding R
	–	–	–	398 250,00
28/02/20.14	117 574,60	89 697,10	27 877,50	308 552,90
31/08/20.14	117 574,60	95 975,89	21 598,70	212 577,01
28/02/20.15	117 574,60	102 694,21	14 880,39	109 882,80
31/08/20.15	117 574,60	109 882,80	7 691,80	–
			72 048,39	

QUESTION 12 (continued)

REQUIRED:

For each of the points (1) to (5) above do the following:

(a) Calculate the amount that should be recognised as revenue in the statement of profit or loss and other comprehensive income of 4x4View Ltd for the year ended 28 February 20.14; and

(b) Give the reasons why this amount is included or excluded as revenue for the year ended 28 February 20.14, according to the requirements of *International Financial Reporting Standards (IFRSs)*.

QUESTION 13 (17 marks)(20 minutes)

Cow Ltd is a manufacturer and distributor of milk powder. During the year the company's competitor introduced a new formula of milk powder with an enhanced nutritional value to the market. In an attempt to retain its market share the company decided to also improve and change its milk powder formula. This change resulted in major restructuring of the company's operations. The company's business operations were relocated to Gauteng and the different distribution outlets were also closed in order to centralise the distribution. The proposed restructuring plan was announced in the media during the current year.

At year-end on 30 September 20.1, the directors of Cow Ltd estimated that the future operating losses to be incurred during the relocation of the business operations will amount to R250 000. The dismantling costs of the equipment at the different distribution outlets are estimated to be R75 000. The dismantling will be done in October 20.1.

The financial director of Cow Ltd estimated that an amount of R50 000 will be spent in the following year for the continuous repair and maintenance of the manufacturing machines due to the fact that the machines are currently operating at their full capacity.

On 25 September 20.1 Moo Ltd, a competitor, instituted a claim of R300 000 against Cow Ltd for a possible infringement of patent rights on the new formula of milk powder. The legal advisors of Cow Ltd are of the opinion that the claim will be unsuccessful. The directors of Cow Ltd estimated that the legal costs to defend the claim will amount to R35 000.

Cow Ltd has a policy to refund purchases to dissatisfied customers within two months from the date of the sale, even though it is under no legal obligation to do so. Its refund policy is generally known and advertised on the packaging of the milk powder. Based on past experience a provision for refunds amounting to R3 000 was made in the annual financial statements of Cow Ltd for the year ended 30 September 20.0. During the current year R13 000 was refunded to dissatisfied customers of which R1 000 related to sales until 30 September 20.0. The financial director estimated, based on the sales figures and past experience, that R1 800 will most probably be refunded to customers in the first two months of the next financial year relating to sales for the year ended 30 September 20.1.

On 1 September 20.1 the shareholders of Cow Ltd decided to terminate the service contract of the managing director due to a conflict of interests. The severance package of the managing director according to his service contract amounted to R450 000. The managing director disputes this amount and considers to take legal action to claim an amount of R600 000. On 30 September 20.1, no cash payment to the managing director has been made yet.

<u>QUESTION 13</u> (continued)

REQUIRED:

Disclose the above information in the statement of financial position and notes to the statement of financial position of Cow Ltd for the year ended 30 September 20.1. Your answer must comply with the requirements of only *IAS 37 - Provisions, contingent liabilities and contingent assets.*

Comparative figures are not required.
Assume that all amounts are material.
Ignore accounting policy notes.

<u>QUESTION 14</u> (26 marks)(31 minutes)

INU Ltd is a retailer, supplier and manufacturer of various generic products and health machines. These generic products and health machines are mainly supplied to the Gauteng health department and to various retail pharmacies in Gauteng. INU Ltd has experienced considerable growth over the past few years and profits have increased considerably. INU Ltd's financial statements for the year ended 31 December 20.2 will be presented to the board of directors for authorization for issue on 20 March 20.3. The current year's profit before tax **before** taking into account the following transactions (1) to (3) amounted to R3 750 000.

The following transactions have not yet been recorded in the books of INU Ltd:

1. "Concentra", a new product, which improves students' concentration by 50%, will be introduced in March 20.3. The future production costs and marketing costs when introduced are estimated at R450 000 and R750 000 respectively.

2. On 30 November 20.2 a client instituted a claim of R50 000 against INU Ltd after becoming violent and seriously ill while using a calming herbal product. One of the ingredients of the product is sage containing tujoon which is medically harmful for certain individuals. On 31 December 20.2 the legal advisors of the company indicated that the claim will be unsuccessful.

3. INU Ltd has a policy of selling all its health machines with a 30 day refund policy for dissatisfied customers. Although it has no legal obligation to do so, its refund policy is generally known to customers who buy the health machines. Based on past experiences, the financial director estimated that R45 000 will most probably be refunded to customers in the first 30 days of the 20.3 financial year relating to sales for the year ended 31 December 20.2. During the financial year ended 31 December 20.1 a refund provision of R40 000 was made. Actual refunds during the 20.2 year relating to sales until 31 December 20.1 amounted to R35 000.

4. On 1 March 20.3, Machine 1 and Machine 5 of seven machines on the manganese production line were damaged, as a result of poor operating procedures followed by operating staff. On 5 March 20.3 a contract was concluded with Repair Ltd to repair these machines for R50 000. The company has excess funds to repair the machines. The manganese production line is not a cash generating unit.

5. On 10 March 20.3 the market value of the listed investment of the 4% shareholding in Snatch Ltd decreased to R450 000. Snatch Ltd is deemed to be a going concern in future.

QUESTION 14 (continued)

REQUIRED:

PART A

Calculate the profit before tax of INU Ltd for the year ended 31 December 20.2 taking into account the above mentioned information (1) to (3) according to the requirements of *IAS 37 - Provisions, contingent liabilities and contingent assets*. List points (1) to (3) above in your answer and indicate next to **each** item the reason why the item has been included or excluded from profit before tax. Marks will be given for reasons even if the item is excluded from the profit before tax. (9½)

PART B

Disclose **only** (2), (3), (4) and (5) in the notes to the annual financial statements of INU Ltd for the year ended 31 December 20.2. Your answer must comply with the requirements of the International Financial Reporting Standards (IFRS).

Comparative figures are not required.
All amounts must be considered material.

Please note: Accounting policy notes are **not** required and disclosure relating to the other transactions are also not required. (16½)

4. SUGGESTED SOLUTIONS TO ADDITIONAL QUESTIONS

SOLUTION 1

a) Calculation of current tax expense for the year ended 31 December 20.1

		R
Profit before tax (given)		120 000
Exempt differences:		(25 000)
Dividends received	(40 000)	
Interest and penalties	15 000	
Profit after exempt differences		95 000
Temporary differences:		30 000
Depreciation	50 000 [1]	
Tax allowance (1)	(64 000)	
Profit on sale of vehicles	(25 000) [2]	
Recoupment on vehicle sold	19 000 [3]	
Provision for warranty costs	50 000	
Taxable income		125 000
Current tax expense @ 28%		35 000

[1] (20 000 + 30 000)
[2] (35 000 − 10 000)
[3] (35 000 − 16 000)

b) Calculation of deferred tax balance for the year ended 31 December 20.1

	Carrying amount R	Tax base R	Temporary differences R	Deferred tax asset/ (liability) @ 28% R
Plant and equipment	140 000	80 000	60 000	(16 800)

The carrying amount of asset > tax base of asset, therefore deferred tax liability.

Motor vehicles	20 000	32 000	12 000	3 360

The carrying amount of asset < tax base of asset, therefore deferred tax asset.

Provision for warranty cost	50 000	-	50 000	14 000

The carrying amount of liability > tax base of liability, therefore deferred tax asset.

Total deferred tax asset at 31 December 20.1	560

Please note:

Marks will only be given in the exam if the deferred tax is calculated according to the **statement of financial position approach**.

SOLUTION 1 (continued)

c) Journal entry

	Dr R	Cr R
Deferred tax (SFP)* (7 840 + 560)	8 400	
Deferred tax (P/L)*		8 400
Provision made for deferred tax movement		

	R
Deferred tax liability – 1 January 20.1 (given)	7 840
Deferred tax asset – 31 December 20.1 (b)	560
Deferred tax movement (cr to P/L)*	8 400

The deferred tax will be accounted for in the general ledger as follows (only for explanatory purposes):

Dr — Deferred tax (SFP)* — Cr

31/12/20.1	Deferred tax expense (P/L)*(balancing figure)		8 400	01/01/20.1	Balance (given)	b/d	7 840
				31/12/20.1	Balance	c/d	560
			8 400				8 400
01/01/20.2	Balance (calculated)	b/d	560				

Dr — Deferred tax expense (P/L)* — Cr

31/12/20.1	Statement of profit or loss and other comprehensive income	8 400	31/12/20.1	Deferred tax (SFP)*	8 400

* SFP = Statement of financial position
P/L = Statement of profit or loss and other comprehensive income

d) KANTON LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.1

2. Income tax expense

Major components of tax expense:	R
Current tax expense – current year (a)	35 000
Deferred tax – current (560(b) + 7 840)	(8 400)
SA normal tax	26 600

Tax rate reconciliation

	R	OR	%
Standard tax rate (120 000 x 28%)	33 600		28,00
Adjusted for exempt differences:			
Dividends received (40 000 x 28%); or (40 000/120 000 x 28% x 100)	(11 200)		(9,33)
Interest and penalties (15 000 x 28%); or (15 000/120 000 x 28% x 100)	4 200		3,50
Effective rate of tax (26 600/120 000 x 100)	26 600		22,17

SOLUTION 1 (continued)

> **COMMENT**
>
> The tax rate reconciliation can be expressed in terms of R-amounts or percentages. Although both methods are acceptable for examination purposes, we suggest that you rather use amounts, as it involves fewer calculations and therefore fewer opportunities for mistakes.

3. Deferred tax
Analysis of temporary differences

	R
Accelerated depreciation for tax purposes (b)(16 800 – 3 360)	(13 440)
Provision for warranty costs (b)	14 000
Deferred tax asset at 31 December 20.1	560

Calculations

1. Tax allowance

	R
Plant and equipment (200 000/5)	40 000
Motor vehicles (120 000/5)	24 000
	64 000

SOLUTION 2

a) Calculation of current tax expense for the year ended 30 June 20.1

	R
Profit before tax	495 000
Exempt differences:	(39 000)
Dividends received	(25 000)
Donations paid	2 000
Incentive allowance received	(16 000)
Profit after exempt differences	456 000
Temporary differences:	3 150
Allowance for credit losses (14 000 − 6 800)	7 200
Credit losses (20.0)(6 800 x 25%)	1 700
Credit losses (20.1)(14 000 x 25%)	(3 500)
Provision for warranties [32 000 − (40 000 − 36 000)]	28 000
Actual warranties paid	(36 000)
Depreciation (205 000/5)	41 000
Tax allowance (205 000/4)	(51 250)
Profit on equipment (125 000 − 96 000)	(29 000)
Recoupment (125 000 − 80 000)	45 000
Taxable income	459 150
Current tax expense @ 28%	128 562

b) Calculation of deferred tax balance for the year ended 30 June 20.1

	Carrying amount	Tax base	Temporary Differences	Deferred tax asset/(liability) @ 28%
	R	R	R	R
Equipment	164 000[1]	153 750[2]	10 250	(2 870)

Carrying amount of asset > tax base of asset, therefore deferred tax liability.

	Carrying amount	Tax base	Temporary Differences	Deferred tax asset/(liability) @ 28%
Trade receivables	88 000	98 500[3]	10 500	2 940

Carrying amount of asset < tax base of asset, therefore deferred tax asset.

SOLUTION 2 (continued)

	Carrying amount R	Tax base R	Temporary Differences R	Deferred tax asset/ (liability) @ 28% R
OR				
Allowance for credit losses	14 000	3 500[4]	10 500	2 940
Carrying amount of liability > tax base of liability, therefore deferred tax asset.				
Provision for warranty costs	32 000	-	32 000	8 960
Carrying amount of liability > tax base of liability, therefore deferred tax asset.				
Deferred tax asset balance at 30 June 20.1				9 030

1 205 000 − 41 000(a)
2 205 000 − 51 250(a)
3 102 000 − (14 000 x 25%)
4 14 000 x 25%

c) Journal entry

	Dr R	Cr R
Deferred tax (SFP)* (9 030 − 8 148)	882	
Deferred tax (P/L)*		882
Provision made for deferred tax movement		

	R
Deferred tax asset – 1 July 20.0 (given)	(8 148)
Deferred tax asset – 30 June 20.1	9 030
Deferred tax movement (cr to P/L)*	882

The deferred tax will be accounted for in the general ledger as follows (only for explanatory purposes):

Dr **Deferred tax (SFP)*** **Cr**

01/07/20.0	Balance (given)	b/d	8 148	30/06/20.1	Balance	c/d	9 030
30/06/20.1	Deferred tax expense (P/L)* (balancing figure)		882				
			9 030				9 030
01/07/20.1	Balance (calculated)	b/d	9 030				

Dr **Deferred tax expense (P/L)*** **Cr**

30/06/20.1	Statement of profit or loss and other comprehensive income	882	30/06/20.1	Deferred tax (SFP)*	882

* SFP = Statement of financial position
P/L = Statement of profit or loss and other comprehensive income

SOLUTION 3

MUAN LTD
NOTES FOR THE YEAR ENDED 31 MARCH 20.8

2. Income tax expense

Major components of tax expense:

	R
Current tax expense – current year	86 934
Deferred tax expense – current (1)	15 826
Deferred tax expense - rate adjustment (1)	(314)
SA normal tax	102 446

Tax rate reconciliation

	R	OR	%
Standard tax rate (430 000 x 28%)	120 400		28,00
Adjusted for exempt differences:			
Fines paid (5 000 x 28%);(5 000/430 000 x 28% x 100)	1 400		0,32
DTI claim received from Government (68 000 x 28%);(68 000/430 000 x 28% x 100)	(19 040)		(4,43)
Adjustment to tax rate (314/430 000 x 100)	(314)		(0,07)
Effective tax rate (102 446/430 000 x 100)	102 446		23,82

3. **Deferred tax**

Analysis of temporary differences

	R
Accelerated capital allowances (22 400 – 6 742)	15 658
Prepaid insurance	8 960
Deferred tax liability – 31 March 20.8	24 618

Calculations

1. Deferred tax expense

	R
Deferred tax liability – 1 April 20.7 (given)	9 106
Rate adjustment (9 106 x 1/29) (cr to statement of profit or loss and other comprehensive income)	(314)
	8 792
Deferred tax liability – 31 March 20.8 (given)	(24 618)
Deferred tax expense (dr to statement of profit or loss and other comprehensive income)	(15 826)

The deferred tax will be accounted for in the general ledger as follows (only for explanatory purposes):

Dr **Deferred tax (SFP)*** **Cr**

01/04/20.7	Deferred tax expense (P/L)* (rate adjustment)		314	01/04/20.7	Balance	b/d	9 106
31/03/20.8	Balance	c/d	24 618	31/03/20.8	Deferred tax expense (P/L)* (balancing figure)		15 826
			24 932				24 932
				01/04/20.8	Balance (calculated)	b/d	24 618

SOLUTION 3 (continued)

Dr		Deferred tax expense (P/L)*			Cr
31/03/20.8	Deferred tax (SFP)*	15 826	01/04/20.7	Deferred tax (SFP)* (rate adjustment)	314
			31/03/20.8	Statement of profit or loss and other comprehensive income	15 512
		15 826			15 826

* SFP = Statement of financial position
P/L = Statement of profit or loss and other comprehensive income

SOLUTION 4

a) Calculation of the current tax expense for the year ended 31 December 20.8

	R
Profit before tax (given)	455 500
Exempt differences:	22 000
Dividends received	(30 000)
Donations and fines	2 000
Depreciation – building	50 000
Profit after exempt differences	477 500
Temporary differences:	(29 500)
Depreciation – plant and machinery	96 000
Allowance for credit losses (50 000 – 40 000)	10 000
Credit losses (20.8) (50 000 x 25%)	(12 500)
Credit losses (20.7) (40 000 x 25%)	10 000
Tax allowance – plant and machinery	(108 000)
Prepaid insurance	(25 000)
Taxable income	448 000
Current tax expense @ 28%	125 440

b) Calculation of deferred tax movement for the year ended 31 December 20.8

	Carrying amount R	Tax base R	Temporary differences R	Deferred tax asset/ (liability) @ 28% R
Plant and machinery	998 000	818 000	180 000	(50 400)
The carrying amount of asset > tax base of asset, therefore deferred tax liability.				
Prepaid expense	25 000	-	25 000	(7 000)
The carrying amount of asset > tax base of asset, therefore deferred tax liability.				
Trade receivables	104 000 [2]	141 500 [3]	37 500	10 500
The carrying amount of asset < tax base of asset, therefore deferred tax asset.				
OR				
Allowance for credit losses	50 000	12 500 [1]	37 500	10 500
The carrying amount of liability > tax base of liability, therefore deferred tax asset.				
Total deferred tax liability at 31 December 20.8				(46 900)

<u>SOLUTION 4</u> (continued)

[1] (50 000 x 25%)

[2] 154 000 – 50 000

[3] 154 000 – (50 000 x 25%)

	R
Deferred tax liability at 31 December 20.7 (given)	40 020
Rate adjustment (40 020 x 1/29)	
(cr to the statement of profit or loss and other comprehensive income)	(1 380)
Deferred tax liability at 31 December 20.8	(46 900)
Deferred tax movement for 20.8	
(dr to the statement of profit or loss and other comprehensive income)	(8 260)

Journal entry	**Dr R**	**Cr R**
Deferred tax (P/L)* (8 260 – 1 380) or (46 900 – 40 020)	6 880	
Deferred tax (SFP)*		6 880
Provision made for deferred tax movement		

The deferred tax will be accounted for in the general ledger as follows (only for explanatory purposes):

Dr — Deferred tax (SFP)* — Cr

01/01/20.8	Deferred tax expense (P/L)* (rate adjustment)		1 380	01/01/20.8	Balance	b/d	40 020
31/12/20.8	Balance	c/d	46 900	31/12/20.8	Deferred tax expense (P/L)* (balancing figure)		8 260
			48 280				48 280
				01/01/20.9	Balance	b/d	46 900

Dr — Deferred tax expense (P/L)* — Cr

31/12/20.8	Deferred tax (SFP)*	8 260	01/01/20.8	Deferred tax (SFP)* (rate adjustment)	1 380
			31/12/20.8	Statement of profit or loss and other comprehensive income	6 880
		8 260			8 260

* SFP = Statement of financial position
P/L = Statement of profit or loss and other comprehensive income

c) Disclosure

AROMA LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.8

2. Deferred tax
Analysis of temporary differences

	R
Accelerated depreciation for tax purposes (b)	50 400
Allowance for credit losses (b)	(10 500)
Prepaid expenses (b)	7 000
Deferred tax liability – 31 December 20.8	46 900

SOLUTION 5

KANNABAS LTD
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 20.2

	20.2 R	20.1 R
Profit before tax	400 000	428 800 [1]
Income tax expense	(112 000)	(120 064)[2]
Profit for the year	288 000	308 736
Total comprehensive income for the year	288 000	308 736

[1] 370 000 + 58 800
[2] 103 600 + (58 800 x 28%)

KANNABAS LTD
EXTRACT FROM THE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 SEPTEMBER 20.2.

	Retained earnings R
Balance at 1 October 20.0	1 440 000
Changes in equity for 20.1	
Total comprehensive income for the year (restated)	308 736
Dividends paid	(150 000)
Balance at 30 September 20.1	1 598 736
Changes in equity for 20.2	
Total comprehensive income for the year	288 000
Balance at 30 September 20.2	1 886 736

KANNABAS LTD
NOTES FOR THE YEAR ENDED 30 SEPTEMBER 20.2

1. Error in respect of prior year

Correction of error in respect of VAT which was incorrectly included in other expenses for 20.1. The effect of the correction of this error on the results of 20.1 is as follows:

	20.1 R
Decrease in expenses	58 800
Increase in current tax expense (58 800 x 28%)	(16 464)
Increase in profit	42 336
Increase in VAT input account	58 800
Increase in current taxation due (SA Revenue Service)	(16 464)
Increase in equity	42 336

COMMENT

Please note that the disclosure requirements for errors in terms of *IAS 8* are quite comprehensive, as the effect of the adjustment on each line item in the statement of profit or loss and other comprehensive income and statement of financial position must be disclosed.

SOLUTION 6

COMMENT

According to *IAS 1 par.39* when an entity applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassify items in its financial statements the entity must, as a minimum, present three statements of financial position as at

(a) the end of the current period
(b) the end of the previous period
(c) the beginning of the earliest comparative period

Please refer to the comprehensive example in ***Descriptive Accounting.***

STOCKIT LTD
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.3

	Note	20.3	20.2
		R	R
Profit before tax		4 511 400[1]	2 068 600[2]
Income tax expense	2	(1 263 192)	(579 208)
Profit for the year		3 248 208	1 489 392
Total comprehensive income for the year		3 248 208	1 489 392

[1] 4 476 000 + 35 400 (1)
[2] 2 040 000 + 28 600 (1)

STOCKIT LTD
EXTRACT FROM THE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.3

	Retained earnings
	R
Balance at 1 July 20.1	2 990 000
Change in accounting policy (130 000(1) x 72%)	93 600
Restated balance	3 083 600
Changes in equity for 20.2	
Total comprehensive income for the year (restated)	1 489 392
Balance at 30 June 20.2	4 572 992
Changes in equity for 20.3	
Total comprehensive income for the year	3 248 208
Balance at 30 June 20.3	7 821 200

STOCKIT LTD
NOTES FOR THE YEAR ENDED 30 JUNE 20.3

2. Income tax expense

	20.3	20.2
Major components of tax expense:	R	R
Current tax expense – current year (2.1)	1 307 600	571 200
Deferred tax expense – current (2.2)	(44 408)	8 008
SA Normal tax	1 263 192	579 208

SOLUTION 6 (continued)

3. Change in accounting policy

During the financial year, the company changed its accounting policy with respect to the valuation of inventory. Stockit Ltd previously accounted for inventory on the last-in, first-out (LIFO) method but has changed its policy of accounting for inventory to the first-in, first-out (FIFO) method in order to comply with the requirements of the *International Financial Reporting Standards (IFRSs)*.

This change in accounting policy has been accounted for retrospectively and the comparative amounts have been appropriately restated. The effect of the change is as follows:

	20.3 R	**20.2 R**	**1/7/20.1 R**
Decrease in cost of sales	35 400	28 600	
Increase in tax expense	(9 912)	(8 008)	
Increase in profit	25 488	20 592	
Increase in inventory	194 000	158 600	130 000
Increase in current taxation due (SA Revenue Service) (194 000 x 28%)	(54 320)	-	-
Increase in deferred tax liability (158 600 x 28%); (130 000 x 28%)	-	(44 408)	(36 400)
Increase in equity	139 680	114 192	93 600
Adjustment to retained earnings at beginning of 20.2			93 600

COMMENT

Please note that due to the fact that the SA Revenue Service will **not** reopen the previous year's tax assessments, the change in accounting policy results in an adjustment to deferred tax in 20.2. The S A Revenue Service accepts the new inventory valuation method that is applied from 20.3, therefore the carrying amount and tax base of closing inventory on 30 June 20.3 is the same.

Calculations

1. Effect of the change in accounting policy

Inventory	**20.1 R**	**Difference R**	**20.2 R**	**Difference R**	**20.3 R**
New method	560 000		1 039 000		1 081 000
Old method	(430 000)		(880 400)		(887 000)
Increase in profit due to increase in inventory	130 000	28 600	158 600	35 400	194 000
Tax effect	(36 400)	(8 008)	(44 408)	(9 912)	(54 320)
	93 600	20 592	114 192	25 488	139 680

2. Income tax expense

2.1 Current tax expense	**20.3 R**	**20.2 R**
Profit before tax (given)	4 476 000	2 040 000
Increase in profit before tax resulting from increase in closing inventory	194 000[1]	- [2]
Taxable income	4 670 000	2 040 000
Current tax expense @ 28%	1 307 600	571 200

<u>SOLUTION 6</u> (continued)

[1] 130 000 + 28 600 + 35 400
[2] Previous tax assessment not reopened – no current tax change

2.2 Deferred tax expense

30 June 20.1	**Carrying amount R**	**Tax base R**	**Temporary difference R**	**Deferred tax liability @ 28% R**
Closing inventory	560 000	430 000	130 000	36 400
The carrying amount of asset > tax base of asset therefore deferred tax liability				
Deferred tax balance 1 July 20.0				-
Deferred tax liability 30 June 20.1				(36 400)
Deferred tax expense (dr to P/L)*				(36 400)
30 June 20.2				
Closing inventory	1 039 000	880 400	158 600	44 408
The carrying amount of asset > tax base of asset therefore deferred tax liability				
Deferred tax liability 1 July 20.1				36 400
Deferred tax liability 30 June 20.2				(44 408)
Deferred tax expense (dr to P/L)*				(8 008)
30 June 20.3				
Closing inventory	1 081 000	1 081 000	-	-
The carrying amount of asset is equal to the tax base of the asset therefore no deferred tax				
Deferred tax liability 1 July 20.2				44 408
Deferred tax balance 30 June 20.3				-
Deferred tax expense (cr to P/L)*				44 408

* P/L = Statement of profit or loss and other comprehensive income

<u>SOLUTION 7</u>

SOLUTION LTD
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 APRIL 20.4

	Notes	**20.4 R**	**20.3 R**
Profit before tax	2	505 000[1]	560 000[2]
Income tax expense	3	(141 400)	(156 800)
Profit for the year		363 600	403 200
Total comprehensive income for the year		363 600	403 200

[1] 620 000 − 90 000(1) − 25 000
[2] 660 000 − 100 000(1)

SOLUTION 7 (continued)

SOLUTION LTD
NOTES FOR THE YEAR ENDED 30 APRIL 20.4

2. Profit before tax	**20.4 R**	**20.3 R**
The profit before tax includes the following items:		
Credit losses	25 000	-
Depreciation	90 000[1]	100 000[2]

[1] (250 000 − 25 000)/2,5
[2] 500 000/5

Included in depreciation is a change in estimate amounting to R10 000. The decrease in depreciation resulted from the decision to change the estimated residual value in respect of equipment from Nil to R25 000 as to reflect the increase in the standard of performance of the equipment. This change will result in an increase of depreciation in future periods of R10 000.

3. Income tax expense

	20.4 R	**20.3 R**
Major components of tax expense:		
Current tax expense – current year (2)	150 472	164 640
Deferred tax expense – current (1)	(9 072)	(7 840)
SA Normal tax	141 400	156 800

4. Events after the reporting period

The company proposed a dividend of R17 500 on 31 May 20.4 to all shareholders registered on 30 April 20.4.

Calculations

1. Deferred tax expense

	Carrying amount R	**Tax base R**	**Temporary difference R**	**Deferred tax asset @ 28% R**
Cost	500 000	500 000	-	-
Depreciation (500 000/5 x 6/12);(500 000/5 x 6/12)	(50 000)	(50 000)	-	-
Carrying amount – 30 April 20.1	450 000	450 000	-	-
Depreciation (500 000/5);(450 000/5)	(100 000)	(90 000)	10 000	2 800
Carrying amount – 30 April 20.2	350 000	360 000	10 000	2 800
Depreciation (500 000/5);(360 000/5)	(100 000)	(72 000)	28 000	7 840
Carrying amount – 30 April 20.3	250 000	288 000	38 000	10 640
Depreciation [(250 000 - 25 000)/2,5];(288 000/5)	(90 000)	(57 600)	32 400	9 072
Carrying amount – 30 April 20.4	160 000	230 400	70 400	19 712

The carrying amount of equipment < the tax base of equipment on 30 April 20.4, therefore a deferred tax asset.

SOLUTION 7 (continued)

2. Current tax expense

	20.4 R	20.3 R
Profit before tax per statement of profit or loss and other comprehensive income		
Depreciation (1)	505 000	560 000
Tax allowance (1)	90 000	100 000
	(57 600)	(72 000)
Taxable income	537 400	588 000
Current tax @ 28%	150 472	164 640

OR

	20.4 R	20.3 R
Profit before tax (given)	620 000	660 000
Tax allowance (1)	(57 600)	(72 000)
Credit losses	(25 000)	-
Taxable income	537 400	588 000
Current tax @ 28%	150 472	164 640

SOLUTION 8

PART A

Definition

Events occurring after the reporting period are those events, both favourable and unfavourable, that occur between the reporting date and the date on which the financial statements are authorised for issue.

Two types of events can be identified:

- those that provide further evidence of conditions that existed at the reporting date (adjusting events after the reporting date), and
- those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date)

PART B

1 (i) Discussion

As the decrease in the market value of the listed investment occurred after the reporting date, it is not necessary to make any adjustments to the assets and liabilities in the financial statements. It appears that the company accounts for listed investments at market value.

(ii) Disclosure

TIK-TAK LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.4

10. Events after the reporting period

During January 20.5 the market value of a listed investment decreased to R500 000. The effect is that net profit is reduced by Rxxx.

SOLUTION 8 (continued)

2 (i)Discussion

As the amount is included in trade receivables at year-end, the reduction in the recoverability of trade receivables at year-end is applicable to the current financial year. Adjustments to assets and liabilities are required for events that occur after the reporting date, and which provide additional information concerning such items in order to determine the amounts in the statement of financial position.

(ii) Disclosure

TIK-TAK LTD
EXTRACT FROM STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.4

	R
Other expenses (Rxxx + R36 190 (1))	xxx
Income tax expense (Rxxx - R10 133 (2))	xxx
(Credit losses written off are tax deductible)	

TIK-TAK LTD
EXTRACT FROM STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.4

ASSETS	**R**
Current assets	
Trade receivables (Rxxx − R36 190(1))	xxx
EQUITY AND LIABILITIES	
Capital and reserves	
Retained earnings (Rxxx − R26 057(3))	xxx
Current liabilities	
SA Revenue Service (Rxxx − R10 133(2))	xxx

(1) 51 700 x 70%
(2) 51 700 x 70% x 28%
(3) 36 190 - 10 133

3 (i)Discussion

If dividends to holders of equity instruments are proposed or declared after the reporting date, in this case on 5 January 20.5, an enterprise should not recognise those dividends as a liability in the statement of financial position at 31 December 20.4.

(ii) Disclosure

TIK-TAK LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.4

10. Events after the reporting period

The directors of the company declared a dividend of 10 cents per share for the year ended 31 December 20.4 on 5 January 20.5. The effect of the dividends declared is that retained earnings are reduced by R10 000.

<u>SOLUTION 8</u> (continued)

4 (i)Discussion

The loss should not be accounted for in the current financial year (i.e. the asset should not be reduced). The cause of the loss is a fire that broke out in January 20.5. This does not relate to conditions that existed at year-end.

(ii)Disclosure

TIK-TAK LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.4

10. Events after the reporting period

A fire broke out in a store in January 20.5. Inventory valued at R16 000 was destroyed. The effect of this is that net profit is reduced by Rxxx.

<u>SOLUTION 9</u>

1a. Identification

Adjusting event – provides further evidence of conditions that existed at the reporting date.

1b. Disclosure

The facts indicate that an asset was impaired at the reporting date. The amount owing by IOU Ltd at 31 March 20.2 amounting to R20 000 should be written off as credit losses in the financial statements at 31 March 20.2. The additional amount of R15 000 supplied on credit after 31 March 20.2 refers to the next period and does not influence the financial statements at 31 March 20.2.

2a. Identification

Non-adjusting event – indicative of conditions that arose after the reporting date.

2b. Disclosure

The loss should not be recognised in the financial statements at 31 March 20.2 as it refers to the following period. It should, however, be disclosed as a note if the non-disclosure thereof will affect the ability of users to make proper evaluations or decisions.

3a. Identification

Not an event after the reporting date. It does not occur between the reporting date and the date when the financial statements are authorised for issue.

3b. Disclosure

Since the extent of the costs as well as the success of the claim is uncertain on 10 June 20.2, the existence of the claim should be disclosed as a note to the financial statements. It is a present obligation arising from past events which is not recognised because the amount of the obligation cannot be measured reliably and it is improbable that it would result in an outflow of economic benefits.

4a. Identification

Non-adjusting event – it does not give additional information on conditions that existed at the reporting date as Dot Ltd was solvent at the reporting date.

SOLUTION 9 (continued)

4b. Disclosure

As Dot Ltd only became insolvent after the reporting date, no adjustments to the financial statements at 31 March 20.2 are necessary. If non-disclosure will affect decision making and evaluation of users, the facts should be disclosed as a note to the financial statements.

5a. Identification

Adjusting event – provides further evidence that an asset was impaired at the reporting date.

5b. Disclosure

Penari Ltd should write off R6 000 [400 x ((R16 000/800) − R5)] of inventory in the financial statements at 31 March 20.2. This will decrease the value of the defective inventory to the lower of cost and net realisable value. The costs to repair the machine will only be recognised when it is incurred, i.e. in the following period.

SOLUTION 10

1. Deluxe washing machines sold with a right of return

a) Identify the performance obligations in the contract

Deluxe washing machines are sold separately by Speedwash Ltd on a regular basis and the buyer can benefit from the good (deluxe washing machine) on its own and therefore the washing machine represents a distinct good (IFRS 15 par .26 – .27). The deluxe washing machines are further not highly interrelated and significant integration in a combined item is not required by the buyer (IFRS 15 par .29). The promised goods (deluxe washing machines) are sold as standard machines from the factory. The sale of the washing machines can therefore be treated as a performance obligation for revenue purposes.

b) Determine the transaction price and allocate the transaction price to the identified performance obligations

The transaction price is the amount of consideration to which Speedwash Ltd expects to be entitled in exchange for transferring the promised goods (deluxe washing machines) to the buyer, excluding amounts collected on behalf of third parties (IFRS 15 par .47). Because the contract allows a customer to return the deluxe washing machines, the consideration received from the customer is variable (IFRS 15 par .50). Speedwash Ltd uses the expected value method (IFRS 15 par .53(a)) to estimate the variable consideration to which the entity will be entitled. Using the expected value method, the entity estimates that 95 percent of the deluxe washing machines will not be returned.

Speedwash Ltd expects to be entitled to an amount equal to the cost price of the washing machine plus 50% for 95 percent of the washing machines sold. The transaction price of revenue will amount to R250 800 (R176 000 x $^{150}/_{100}$ x 95%).

Speedwash Ltd determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for deluxe washing machines and the uncertainty will be resolved within a short time frame (the 30-day return period) (IFRS 15 par .56 – .58). Speedwash Ltd therefore concludes that it is highly probable that a significant reversal in the cumulative revenue recognised amounting to R250 800 will not occur as the uncertainty is resolved.

<u>SOLUTION 10</u> (continued)

c) Recognise revenue from contracts with customers

Speedwash Ltd should recognise revenue when the entity satisfies the performance obligation by transferring the deluxe washing machines (IFRS 15 IN 7(e)). An asset (goods or services) is transferred when the buyer obtains control of that asset and has the ability to direct use of the asset and receive the benefit from the asset. The buyer obtains control over the deluxe washing machines when payment is made by the customer to Speedwash Ltd.

Upon transfer of control of the 20 deluxe washing machines, Speedwash Ltd does not recognise revenue for the 5% expected to be returned. Speedwash Ltd recognises the following for the financial year ended 30 June 20.14:

- revenue amounting to R250 800 (R176 000 x $^{150}/_{100}$ x 95%) deluxe washing machines not expected to be returned) should be recognised in the statement of profit or loss and other comprehensive income;
- a refund liability amounting to R13 200 (R176 000 x $^{150}/_{100}$ x 5%) for deluxe washing machines expected to be returned and a contract asset of R8 800 (R176 000 x 5%) for its right to recover deluxe washing machines from customers on settling the refund liability, should be disclosed in the statement of financial position.

2. Domestic washing machines with principal versus agent considerations

a) Identify the performance obligations in the contract

Consideration as to whether Speedwash Ltd is acting as an agent or a principal is important to determine the performance obligation in the contract. Speedwash Ltd is involved in providing goods to customers and should determine whether the nature of its promise is to provide the specified goods itself (principal) or to arrange for the other party to provide those goods (agent) (IFRS 15 Appendix B, par .B34).

An entity is an agent if its performance obligation in the contract (arrangement) is to arrange for the provision of goods or services by another party. The following indicates that Speedwash Ltd is acting as an agent:

- the entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited;
- the entity's consideration is in the form of a commission; and
- the entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services (IFRS 15 Appendix B, par .B37).

As Speedwash Ltd acts as an agent in the contract, the identified performance obligation is to arrange for goods or services to be provided to customers on behalf of the foreign company.

b) Determine the transaction price and allocate the transaction price to the identified performance obligations

When an entity that is an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the other party to provide its goods or services (IFRS 15 Appendix B, par .B36) Speedwash Ltd expects to be entitled to 15% commission on the agreed upon sales price of R9 500. The transaction price of revenue will therefore amount to R128 250 (R9 500 x 90 x 15%).

c) Recognise revenue from contracts with customers

Speedwash Ltd should recognise revenue when the entity satisfies the performance obligation by transferring the promised goods (domestic washing machines). An asset (goods or services) is

SOLUTION 10 (continued)

transferred when the buyer obtains control of that asset and has the ability to direct use of the asset and receive the benefit from the asset. The buyer obtains control over the asset at the point of delivery of the domestic washing machines as the buyer then has a present obligation to pay for the asset and is in possession of the asset. As cash has been received and delivery made for the domestic washing machines revenue amounting to R128 250 (R9 500 x 90 x 15%) should therefore be recognised for the financial year ending 30 June 20.14.

3. Commercial dryers sold with warranties

a) Identify the performance obligations in the contract

- Some warranties provide customers with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications, while others provide the customer with a service in addition to the above noted assurance (IFRS 15 Appendix B, par .B28). If a customer has the option to purchase a warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract (IFRS 15 Appendix B, par .B29). The following factors indicate that the warranty provides a service in addition to the assurance that the product complies with agreed-upon specifications:

  - The warranty is not required by law.
  - The warranty coverage period is three (3) years therefore it is more likely to provide a service in addition to the above discussed assurance (IFRS 15 Appendix B, par .B31).

  If a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, the promised service must be a separate performance obligation (IFRS 15 Appendix B, par .B32).

- The buyer can benefit from the commercial dryers on its own and the commercial dryers are separately identifiable from the warranty in the contract. The commercial dryers therefore represent distinct good and should be treated as a separate performance obligation for revenue purposes (IFRS 15 Appendix B, par .B29).

  Based on the above discussion, two separate performance obligations have been identified in the contract, being the commercial dryer and the warranty.

b) Determine the transaction price and allocate the transaction price to the identified performance obligations

The transaction price is the amount of consideration to which Speedwash Ltd expects to be entitled in exchange for transferring the promised goods and services (IFRS 15 par .47). Speedwash Ltd expects to be entitled to an amount equal to the selling price of R20 000 for the sale of commercial dryers with warranties. Therefore the transaction price of revenue for the sale of the 2 commercial dryers with warranty policies will amount to R40 000 (2 x R20 000). Speedwash Ltd should allocate the transaction price to the product (commercial dryer) and the service (warranty) based on their relative stand-alone selling prices.

	Stand-alone selling prices	**Allocation percentage**	**Allocated transaction price**
Commercial dryers	R18 750	88,23%[1]	R17 646
Warranty policy	R2 500	11,77%[2]	R2 354
	R21 250		R20 000

1 $\frac{18\,750}{21\,250}$

2 $\frac{2\,500}{21\,250}$

<u>SOLUTION 10</u> (continued)

c) Recognise revenue from contracts with customers

Speedwash Ltd should recognise revenue when the entity satisfies the performance obligation by transferring the promised goods (commercial dryers) and services (warranties). An asset (goods or services) is transferred when the buyer obtains control of that asset and has the ability to direct use of the asset and to receive the benefit from the asset.

The buyer obtains control over the commercial dryer at the point of delivery of the commercial dryers. The buyer however simultaneously receives and consumes the benefits provided by the warranty and therefore should recognise revenue over time (the period of time lapsed to total expected time might be appropriate as an input method).

Speedwash Ltd recognises the following revenue amounts for the financial year ended 30 June 20.14:

- R35 292 (R17 646 x 2 for commercial dryers);
- R131 (R2 354 x 2 x $^{1\text{ month}}/_{36\text{ months}}$ for warranties).

<u>SOLUTION 11</u>

a) Profit before tax

	Comments	R
Profit before tax (given)		1 400 000
1. Consignment sales (R500 000 x 80%)	1	400 000
2. Sale of goods already manufactured	2	75 000
3. Sale of goods still to be manufactured	2	–
4. Non cash consideration		–
Fair value of non-cash consideration can be reasonably estimated	3	
Transaction price measured at fair value of non-cash consideration (20 x R2 750)		55 000
Fair value of non-cash consideration cannot be reasonably estimated	3	
Transaction price measured by reference to the stand-alone selling price of the goods promised to the customer (2 x R3 600)		7 200
5. Royalties received (500 x R100)	4	50 000
6. Lay away sales	2	–
Adjusted profit before tax		1 987 200

Comments

1. When Gracoo Ltd delivers a product to another party (Bunnee Ltd) for sale to end customers (the customers of Bunnee Ltd), Gracoo Ltd shall evaluate whether Bunnee Ltd has obtained control of the product at that point in time. A product that has been delivered may be held in a consignment arrangement if Bunnee Ltd has not obtained control of the product. Accordingly, an entity shall not recognise revenue upon delivery of a product to another party if the delivered product is held on consignment (IFRS 15 Appendix B, par .B77). Gracoo Ltd will therefore recognise 80% of revenue as Bunee Ltd has sold 80% of the goods to its end customers.

2. If a customer pays consideration, or an entity has an unconditional right to an amount of consideration (a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has already received consideration (or an amount of consideration is due) from the customer (IFRS 15 par .106).

SOLUTION 11 (continued)

In accordance with paragraph 106, upon receipt of a prepayment from a customer, an entity shall recognise a contract liability in the amount of the prepayment for its performance obligation to transfer, or to stand ready to transfer, goods or services in the future. An entity shall derecognise that contract liability (and recognise revenue) when it transfers those goods or services and, therefore, satisfies its performance obligation. (IFRS 15 Appendix B, par. B44)

3. To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value (IFRS 15 par .66).

   If an entity cannot reasonably estimate the fair value of the non-cash consideration, the entity shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration (IFRS 15 par. 67).

4. An entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

   a) the subsequent sale or usage occurs; and
   b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied) (IFRS 15 Appendix B, par .B63).

SOLUTION 12

1. Caravan sales

1.1 R9 130 000 [R10 408 200 x 100/114] or [83 x (125 400 x 100/114)]

1.2 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, VAT) (IFRS 15 par .47). Value added tax is an amount collected on behalf of a third party and therefore is excluded from the transaction price.

When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price that is allocated to that performance obligation (IFRS 15 par .46). The transfer of the legal title and the responsibility of both maintenance and insurance indicate that the point in time at which Mr Wild obtains control of the promised asset and 4x4View Ltd satisfies its performance obligation on 28 March 20.14 (IFRS 15 par .38(b)). Revenue should only be recognised for the 83 caravans as legal title of the 2 caravans have not been transferred to Mr Wild at year end. These caravans were only registered in Mr Wild’s name after year end.

2. Adventure tour sales

2.1 R72 500 [25 000 + (55 000 x $^{2\text{ weeks}}/_{4\text{ weeks}}$) + 20 000]

2.2 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset (IFRS 15 par .31).

The entity has a present right to payment for the asset – if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange (IFRS 15 par .38 (a)). The performance obligation to make the necessary bookings and pay the conservation fees is satisfied one month before the date of the tour. Therefore the transaction price relating to the game

<u>SOLUTION 12</u> (continued)

park bookings and conservation fees for both the tour starting 15 February 20.14 and 15 March 20.14 should be recognised during the current financial year ending 28 February 20.14.

The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (IFRS 15 par .35 (a)) and therefore the performance obligation is satisfied over time. The performance obligation to provide a guided tour is satisfied during the course of the tour. Therefore the transaction price relating to the guided tour for the tour starting 15 February 20.14 should be recognised for the period of the guided tour that has already lapsed during the financial year ended 28 February 20.14. Progress towards complete satisfaction of the performance obligation is based on the output method of time elapsed (IFRS 15 Appendix B, par .B15).

3. Consignment sales

3.1 R38 750 [(R45 000 - R14 000) x 100/80]

3.2 When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity shall evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, an entity shall not recognise revenue upon delivery of a product to another party if the delivered product is held on consignment. (IFRS 15 Appendix B, par .B77). Revenue is therefore recognised by the seller when the goods are sold to a third party by another party (such as the dealer or distributor).

4. T-shirt sales

4.1 Rnil

4.2 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset (IFRS 15 par .31). Revenue is not recognised since the promised t-shirts have not been transferred to the buyer. Revenue is only recognised when the t-shirts are delivered to the buyer on 3 March 20.14. A contract liability shall be recognised for the amount of consideration received from FarOut Ltd in the statement of financial position for the year ended 28 February 20.14 (IFRS 15 par .106).

5. Trailer sales

5.1 R470 337,50 [(88 500 x 5) + 27 877,50]

5.2 The customer has the significant risks and rewards of ownership of the asset – the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from the asset. (IFRS 15 par .38). Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale as Mr Wild is able to use the trailers in his business and obtain substantially all of the remaining benefits.

An entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. (IFRS 15 par .64). An entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of profit or loss and other comprehensive income. Interest revenue or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer (IFRS 15 par .65). Therefore the interest element is recognised as revenue as it is earned, over time as Mr Wild simultaneously receives and consumes the benefits provided by 4x4View Ltd for the extended payment terms.

SOLUTION 13

COW LTD
STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 20.1

	Note	20.1 R
EQUITY AND LIABILITIES		
Current liabilities		
Provisions (75 000 + 1 800 + 450 000)	1	526 800

COW LTD
NOTES FOR THE YEAR ENDED 30 SEPTEMBER 20.1

1. Provisions

1.1 Provision for the dismantling of the equipment due to the closure of the different distribution outlets.

	R
Carrying amount 30 September 20.0	–
Provisions made during the year	75 000
Carrying amount 30 September 20.1	75 000

Provision has been made for the dismantling of the equipment due to the closure of the different distribution outlets which are expected to be incurred during the first month of the new financial year.

1.2 Provision for refunds

	R
Carrying amount 30 September 20.0	3 000
Amount used during the year	(1 000)
Unused amounts reversed during the year/(transferred to income)	(2 000)
Additional provision made during the year	1 800
Carrying amount 30 September 20.1	1 800

Provision has been made for the refund of purchases to dissatisfied customers within 2 months of the date of sale. It is expected to be incurred within the first two months of the financial year.

1.3 Provision for severance package

	R
Carrying amount 30 September 20.0	-
Provision made during the year	450 000
Carrying amount 30 September 20.1	450 000

Provision has been made for the severance package payable to the managing director whose service contract was terminated on 1 September 20.1 due to a conflict of interests.

2. Contingent liability

A claim of R300 000 for the infringement of patent rights on the new formula of milk powder was instituted against the company during the year. The company's legal advisors are of the opinion that the claim will be unsuccessful.

<u>SOLUTION 13</u> (continued)

> **COMMENT:**
>
> 1. **Future operating losses:** IAS 37 clearly states that provisions should not be raised for future operating losses. The recognition criteria of a provision require a legal or constructive obligation as a result of a past event leaving the company with no realistic alternative. In this case, future operating losses, which are outflows of economic benefits, should not be raised, as the event creating the obligation has not occurred.
>
> 2. **Continuous repair and maintenance costs:** There is no legal obligation to incur future repairs and maintenance costs on manufacturing machines. In terms of IAS 37, a provision should only be raised for a liability arising from a past event. A provision in this case should not be raised, as these costs relate to repairs and maintenance that will be incurred in the future. In some circumstances an enterprise may be under a constructive or legal obligation to maintain its assets to a specified level of performance to be able to operate them. Even in these circumstances the accounting treatment is not to recognise a provision. Any commitments to make good the asset will be capitalised when the expenditure has been incurred, and depreciated over the useful life of the asset.

The provisions in the question will be journalised as follows for the year ended 30 September 20.1 **(for explanation purposes only, but you should be able to prepare them):**

		Debit R	Credit R
(1)	Dismantling costs (P/L)*	75 000	
	Provision for dismantling of equipment (SFP)*		75 000
	Being provision made for dismantling of equipment due to closure of distribution outlets.		
(2)	Severance package costs (P/L)*	450 000	
	Provision for severance package (SFP)*		450 000
	Being provision made for severance package costs payable to the managing director whose contract terminated on 1 September 20.1		
(3)	Refunds (13 000 – 1 000) (P/L)*	12 000	
	Provision for refunds (SFP)*	1 000	
	Bank		13 000
	Being refunds paid in respect of sales during the year ended 30 September 20.0 and 30 September 20.1		
(4)	Provision for refunds (SFP)*	2 000	
	Refunds (P/L)*		2 000
	Being provision for refunds not used (reversed) transferred to income in respect of sales made during 30 September 20.0		
(5)	Refunds (P/L)*	1 800	
	Provision for refunds (SFP)*		1 800
	Being provision raised for possible refunds of sales during the year ended 30 September 20.1		

* SFP = Statement of financial position
P/L = Statement of profit or loss and other comprehensive income

SOLUTION 14

PART A

	R
Profit before tax (given)	3 750 000
1. New product introduced – Concentra	–
Provision for future costs should not be recognised as the general recognition criteria as set out in terms of IAS 37 par 14 are not met, viz a present obligation at reporting date does not exist. A contingent liability will also not be recognised as there is no past event.	
2. Claim from customer	–
A provision cannot be raised since the legal advisors have indicated that the claim will not succeed. However a contingent liability should be disclosed. A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed by the occurrences or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. (IAS 37 par 10)	
3. Refund policy	(40 000)
Since a constructive obligation exists, a provision can be made. A constructive obligation is an obligation that is derived by an established pattern of past practices, published policies or a sufficiently specific current statement; the enterprise has indicated to other parties that it will accept certain responsibilities and as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities. (IAS 37 par 10)	
Profit before tax after taking into account items (1) to (3)	3 710 000

[1] 45 000 − 5 000

PART B

DISCLOSURE

INU LTD
NOTES FOR THE YEAR ENDED 31 DECEMBER 20.2.

1. Contingent liability

A claim of R50 000 was instituted against the company for selling a calming herbal product to a customer which is medically harmful. The company's legal advisors are of the opinion that the claim will be unsuccessful.

2. Provision for refunds for health machines

	R
Carrying amount 31 December 20.1	40 000
Amount used during the year	(35 000)
Unused amounts reversed during the year/(transferred to income)	(5 000)
Provision made during the year	45 000
Carrying amount 31 December 20.2	45 000

Provision has been made for the refund of purchases to dissatisfied customers within 30 days of the date of sale. It is expected to be incurred within 30 days of the next financial year.

SOLUTION 14 (continued)

3.1 Events after the reporting period

On 1 March 20.3, two machines were damaged due to poor operating procedures followed by operating staff. Damage to the two machines amounted to R50 000.

3.2 Contract for capital expenditure

A contract was concluded with Repair Ltd to repair the damaged machines for R50 000. The company has excess funds of R50 000 to finance the repair.

4. Events after the reporting period

On 10 March 20.3 the market value of a listed investment dropped to R450 000.