Tutorial Letter 202/2/2014

Selected Accounting Standards and Simple Group Structures

FAC2602

Semester 2

Department of Financial Accounting

This tutorial letter contains important information about the module.

Bar code

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CONTENTS

1 GENERAL

Dear Student,

Attached hereto please find the solution to assignment 02/2014.

It is in your own interest to work through the suggested solution in conjunction with the assignment and your own answer. Analyse your answer against the solution and ask yourself whether you understand why the solution is correct where your answer differed. Revise the tutorial matter and the assignments regularly. By repeatedly working through these questions under examination conditions (i.e. with no interruptions and within the time allowed), you will improve your knowledge of the subject and your examination technique.

Kind regards

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2 SOLUTION TO ASSIGNMENT 02/2014 – SEMESTER 2

QUESTION

1.	(4)	6.	(3)
2.	(3)	7.	(2)
3.	(4)	8.	(1)
4.	(4)	9.	(1)
5.	(1)	10.	(4)

Detailed explanations:

1. The correct pro-forma consolidated journal entry to eliminate the unrealised profit in closing inventories is:

	Dr R	Cr R
Cost of sales - Bath Ltd	17 600	
Inventories – Ocean Ltd		17 600

PLEASE NOTE:

- Bath Ltd sells inventory at a profit of 25% to Ocean Ltd. Ocean Ltd's inventory includes this profit and Bath Ltd's profit includes the amount as well. Since we evaluate the companies as one group, we need to eliminate the intragroup profit, or unrealised profit, as it was profit generated from within the group, but not realised outside the group.

- At year end, Ocean Ltd has inventory obtained from Bath Ltd, amounting to R88 000, in their financial records. To calculate the unrealised profit portion, recognise that the R88 000 already includes 25% profit, therefore the R88 000 equals 125%. The profit of 25% is calculated as follows: R88 000 x 25/125 = R17 600.

- To eliminate the unrealised profit, Ocean Ltd has to subtract it from its closing inventory, i.e. inventory should be credited. Bath Ltd has to decrease its profit by debiting cost of sales.

2. The correct pro-forma consolidated journal entry to eliminate the owners' equity of Bath Ltd at acquisition, is:

	Dr R	Cr R
Share capital	180 000	
Retained earnings	34 500	
Revaluation surplus	80 000	
Goodwill	4 125	
Non-controlling interests [180 000 + 34 500 + 8 000) x 25%]		73 625
Investment in Bath Ltd		225 000

Analysis of owners' equity of Bath Ltd

	Total	Ocean Ltd 75%		NCI 25%
		At	**Since**	
	R	**R**	**R**	**R**
At acquisition				
Share capital	180 000	135 000		45 000
Retained earnings	80 000	60 000		20 000
Revaluation surplus	34 500	25 875		8 625
	294 500	220 875		73 625
Equity represented by goodwill – parent	4 125	**4 125**		-
Consideration and NCI	298 625	225 000		73 625

PLEASE NOTE:

- One of the first adjustments which should be made when consolidating is the elimination of the investment in the parent's financial records and the owners' equity section in the subsidiary's financial records at acquisition date. All intragroup transactions must be eliminated, because the group is regarded as one economic entity and will not enter into transactions with itself.

- The question did not clearly state when the R100 000 included in the revaluation surplus of Bath Ltd (R180 000 – R80 000) arose. As it could be before the acquisition date, in which case it would also have been eliminated at acquisition, students were not penalised and automatically received the marks for this question, as this question might have caused confusion.

3. The correct pro-forma consolidated journal entry to eliminate the unrealised profit in opening inventory, is:

	Dr	Cr
	R	**R**
Retained earnings - Bath Ltd	11 000	
Cost of sales – Bath Ltd		11 000

PLEASE NOTE:

- On consolidation we have to annually repeat all the entries, because we combine the individual companies' financial statements every year and these statements do not contain the consolidation entries of the previous years. If profit was affected in the previous year, the adjustment will be made against retained earnings in the current year. Therefore the cost of sales of R11 000 that was debited against cost of sales the previous year, will be debited against retained earnings in the current year.

- Due to the general view that the operating cycle of entities is a year, we assume that this inventory has actually been sold to outside parties within that year, hence the profit is realised. Therefore the cost of sales of Bath Ltd is credited to increase profit again.

4. The correct pro-forma consolidated journal entry to record the non-controlling interests’ share in the revaluation surplus arising from the revaluation of land and buildings since acquisition, is:

	Dr R	Cr R
Revaluation surplus - Bath Ltd	25 000	
Non-controlling interests (SFP) [(180 000 – 80 000) x 25%]		25 000

PLEASE NOTE:

- Students need to know that the revaluation surplus of R80 000 at acquisition has been eliminated. The remaining amount should be calculated and allocated to the non-controlling interests as follows: (R180 000 – R80 000) x 25% = R25 000.
- The revaluation surplus should decrease by R25 000 (debited) to allow that it be allocated to the non-controlling interests in the consolidated statement of financial position.
- The question did not clearly state when the R100 000 included in the revaluation surplus of Bath Ltd was incurred. As it could be before the acquisition date, in which case the entry above would not be made, students were not penalised and automatically received the marks for this question, as this omission might have caused confusion.

5. The correct pro-forma consolidated journal entry to eliminate the unrealised profit on the sale of machinery is:

	Dr R	Cr R
Retained earnings - Ocean Ltd (R22 000 – R14 000)	8 000	
Machinery - Bath Ltd		8 000

PLEASE NOTE:

- As the sale occurred in the previous year, the unrealised profit is eliminated by debiting the retained earnings of Ocean Ltd.
- The machinery is owned by Bath Ltd, therefore intragroup profit must be eliminated against Bath Ltd’s machinery.

6. The correct pro-forma consolidated journal entry to eliminate the current year’s depreciation associated with the sale of the machinery, is:

	Dr R	Cr R
Accumulated depreciation – Bath Ltd (R8 000/5)	1 600	
Depreciation – Ocean Ltd		1 600

	PLEASE NOTE: - In Bath Ltd's individual financial records, Bath Ltd depreciates machinery that still includes the unrealised profit of R8 000. Excessive depreciation is therefore provided. To eliminate this, accumulated depreciation is debited (normally accumulated depreciation is credited when depreciation is provided for). The amount is calculated as: R8 000 (unrealised profit) / 5 (useful life of machinery in years). - As Ocean Ltd made the profit and the profit was eliminated in Ocean Ltd's records (question 5), everything that affects profit or retained earnings will occur in Ocean Ltd's records. As this machine is used, the profit that was first unrealised, now realises through use of the asset, over the remaining useful life of the machinery, at the rate of depreciation. Therefore the retained earnings or profit should be credited again as the profit is now realised bit by bit through use of the asset. In the current year Ocean Ltd's depreciation is credited and for the previous years the retained earnings of Ocean Ltd is credited.

7. The correct pro-forma consolidated journal entry to eliminate the previous years' depreciation associated with the sale of the machinery:

	Dr R	Cr R
Accumulated depreciation - Bath Ltd (8 000/5 x 8/12)	1 067	
Retained earnings - Ocean Ltd		1 067

8. The correct pro-forma consolidated journal entry to record the non-controlling interests' share in the dividends paid, is:

	Dr R	Cr R
Non-controlling interests (SFP) (50 000 x 25%)	12 500	
Dividends paid - Bath Ltd		12 500

	PLEASE NOTE: - Dividends paid by the subsidiary are always eliminated, as it is paid within the group. Dividends paid have a debit balance and dividends received a credit balance, as it is an income. To eliminate it, dividends received by Ocean Ltd are debited and dividends paid by Bath Ltd are credited. However, this question only requires the journal of the non-controlling interests' share of the dividends. Non-controlling interests are debited, thereby reducing their balance in the statement of financial position, as they realised a portion of their share in the profit in the form of a dividend received.

9. The correct pro-forma consolidated journal entry to eliminate the intragroup bills is:

	Dr R	Cr R
Bills payable to Bath Ltd - Ocean Ltd	45 000	
Bills receivable from Ocean Ltd - Bath Ltd		45 000

PLEASE NOTE:

On consolidation the intragroup transactions are eliminated. Bills receivable from Ocean Ltd, which has a debit balance of R45 000 in Bath Ltd's financial records, must be eliminated by crediting it. Likewise, bills payable to Bath Ltd, which has a credit balance in the financial records of Ocean Ltd, must be debited by R45 000 to eliminate the intragroup portion.

10. The correct pro-forma consolidated journal entry to eliminate the intragroup sales is:

	Dr R	Cr R
Sales - Bath Ltd	600 000	
Cost of sales - Ocean Ltd		600 000

Calculations and disclosure (disclosure included for completeness, but not required in the question):

Analysis of Owners' equity of Bath Ltd		**Ocean Ltd 75%**		**25%**
	Total	**At**	**Since**	**NCI**
	R	**R**	**R**	**R**
At acquisition				
Share capital	180 000	135 000		45 000
Retained earnings	34 500	25 875		8 625
Revaluation surplus	80 000	60 000		20 000
	294 500	220 875		73 625
Equity represented by goodwill - parent	4 125	4 125		-
Consideration and NCI	298 625	225 000		④73 625
Since acquisition				
To beginning of current year				
Retained earnings	153 040		③114 780	⑤38 260
At 1/7/2012	198 540			
At acquisition	(34 500)			
	164 040			
Unrealised profit in opening inventory (55 000 x 25/125)	(11 000)			
Current year				
Profit for the year	179 160		134 370	⑧44 790
Profit before tax	258 000			
Income tax expense	(72 240)			
	185 760			
Unrealised profit in opening inventory	11 000			
Unrealised profit in closing inventory (88 000 x 25/125)	(17 600)			
Revaluation surplus (180 000 – 80 000)	100 000		①75 000	⑨25 000
Dividends paid	(50 000)		(37 500)	⑦(12 500)
			OCE 75 000	
	680 825		RE 211 650	169 175

OCEAN LTD GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2013

	R
Profit before tax (332 600 + 258 000 + 11 000 - 17 600 + 1 600)	585 600
Income tax expense (93 128 + 72 240)	(165 368)
PROFIT FOR THE YEAR	②420 232
Other comprehensive income for the year	100 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	520 232
Total comprehensive income attributable to:	
Owners of the parent (520 232 – 69 790)	450 442
Non-controlling interests (44 790 + 25 000)	⑥69 790
	520 232

OCEAN LTD GROUP
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2013

	Share capital R	Revaluation surplus R	Retained earnings R	Total R	Non-controlling Interests R	Total equity R
Balance at 1 July 2012	300 000	150 000	285 827[a]	735 827	111 885[b]	847 712
Changes in equity for 2013						
Total comprehensive income for the year		75 000	375 442	450 442	69 790	520 232
Profit for the year			375 442[c]	375 442	⑧44 790	420 232
Other comprehensive income		①75 000		75 000	⑨25 000	100 000
Dividend declared			(40 000)	(40 000)	⑦(12 500)	(52 500)
Balance at 30 June 2013	300 000	225 000	621 269	1 146 269	169 175	1 315 444

[a] 177 980 + 114 780③ – 8 000 (unrealised profit on sale of machinery) + 1067 (unrealised depreciation)
[b] 73 625④ + 38 260⑤
[c] 420 232② - 44 790⑧

OCEAN LTD GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2013

	R
ASSETS	
Non-current assets	
Property, plant and equipment (500 000 + 530 000 + 150 000 + 120 000 – 58 000 – 80 000 – 8 000 + 1 067 + 1 600)	1 156 667
Goodwill	4 125
	1 160 792
Current assets	
Inventories (138 000 + 65 000 – 17 600)	185 400
Trade and other receivables (339 850 + 378 246)	718 096
Cash and cash equivalents	24 554
	928 050
Total assets	2 088 842
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital	300 000
Other components of equity	225 000
Retained earnings	621 269
	1 146 269
Non-controlling interests	169 175
Total equity	1 315 444
Current liabilities	
Trade and other payables (265 000 + 338 500)	603 500
Dividends payable (40 000 + 50 000 - 37 500)	52 500
Bank overdraft	112 398
Bills payable(50 000 - 45 000)	5 000
	773 398
Total equity and liabilities	2 088 842