

FAC3703 – SPECIFIC FINANCIAL REPORTING

DISCUSSION CLASSES 2012

PRESENTERS

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FAC3703 – Programme

PROGRAMME

08H00 – 08H15	Welcome and introduction
08H15 – 09H00	Borrowing Cost
09H00 – 09H45	Leases
09H45 – 09H55	Financial instruments
09H55 – 10H20	Break
10H20 – 10H50	Government assistance
10H50 – 11H20	Segment reporting
11H20 – 11H50	Employee Benefits
11H50 – 12H05	Break
12H05 – 12H35	Earning per share
12H35 – 12H50	Related parties
12H50 – 13H00	Questions/Discussion

CONTENT

PLEASE NOTE:

- The purpose of the discussion class is to highlight issues identified and not to cover the entire syllabus.
- The time spend per study unit does not indicate the importance of it and should not be used as guidance when preparing for the examination.
- Therefore, please ensure that you study all units in the study guide, tutorial letters and other official study material.
- **Do not only study the notes to the discussion class!**

Borrowing Cost – IAS 23

1. Concept/Basic explanation of borrowing cost

It is the capitalisation (addition to the cost of the asset) of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

Borrowing cost = Interest and other costs incurred in connection with the borrowing of funds

In my own words – You borrow money to acquire, construct or produce a qualifying asset. You then pay interest or other cost on the money borrowed. A part or all of this interest or other cost will be CAPITALISED (added to the cost price of the asset) towards the cost price of the asset. (depending on certain rules and timeframes, for example when is the asset ready to use)

PS! – This is a short, simple description. Unfortunately there is certain rules that you should first study, for example what is borrowing cost, what is a qualifying asset etc. Refer to study unit 3 in the study guide as well as IAS 23.

Borrowing Cost – IAS 23

You should now understand the basic principle of IAS 23. As with all accounting standards, there are different rules/principles that should be applied, depending on the scenario:

Other rules, principles and scenarios that should be considered:

(These are only a few students normally struggle with. For completeness, refer to study unit 3 in the study guide as well as IAS 23

- Borrowing cost
- Specific loans
- General loans
- General pool of funds
- Interest received (investment income)
- Capitalisation
 - By the bank or other financial institution
 - Capitalisation of borrowing cost towards the asset by the entity
- Cessation of capitalisation (stop to add borrowing cost towards the asset)
 - READY FOR USE**
- Tax implications
 - PRE-PRODUCTION INTEREST AS A DEDUCTION – BROUGHT INTO USE**
- Expenses incurred:
 - Beginning of period
 - Evenly over period
 - At the end of the period
- Combination of funding sources (example loan and overdraft)
- Disclosure (refer to study unit 3 in the study guide as well as IAS 23)

Borrowing Cost – IAS 23

Simple example to explain the concept:

A constructs a vehicle. Construction starts on 1/1/2012 and the vehicle was ready for use on 30/4/2012. A incurs expenditure as follow:

1/1/2012 - Buys vehicle body for R 100

1/2/2012 - Buys tyres for R 10

1/3/2012 – Buys other parts for R 5

A has an overdraft facility of R 115 at X Bank to construct the vehicle. X Bank charges A interest of R 8 (R 2 a month for the 4 months starting at 1/1/2012 ending at 30/4/2012. A will pay the interest to X at the end of month 4 from cash available in Z Bank account.

Borrowing Cost – IAS 23

T accounts if there was no IAS 23:

Motor Vehicles – Cost (SFP)

X Bank(Body)	100	
X Bank(Tyres)	10	
X Bank(Other Parts)	5	

X Bank (overdraft) (SFP)

	MV–Cost(Body)	100
	MV–Cost(Tyres)	10
	MV–Cost(Other parts)	5

T accounts taking IAS 23 into account:

Motor Vehicles – Cost (SFP)

X Bank(Body)	100	
X Bank(Tyres)	10	
X Bank(Other Parts)	5	
Z Bank(Borrowing cost capitalised)	8	

X Bank (overdraft) (SFP)

	MV–Cost(Body)	100
	MV–Cost(Tyres)	10
	MV–Cost(Other parts)	5

Borrowing Cost – IAS 23

T accounts if there was no IAS 23:

Interest expense (SPL)	
Z Bank	8

Z Bank (SFP)	
	Interest expense 8

Other notes:

- Depreciation will be calculated on the total cost of the asset of R115

T accounts taking IAS 23 into account:

Interest expense (SPL)	

Z Bank (SFP)	
	MV – Cost 8 (borrowing cost capitalised)

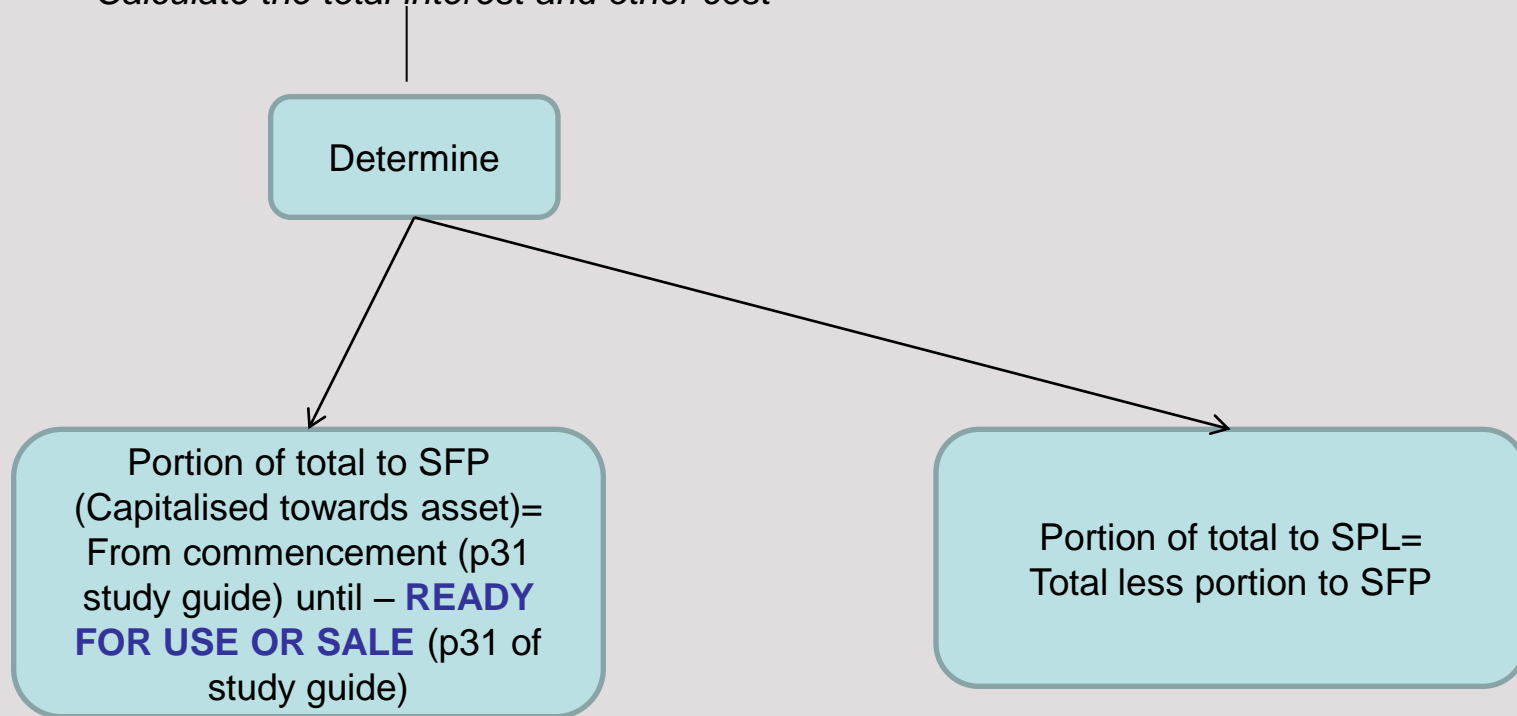
Other notes:

- Depreciation will be calculated on the total cost of the asset of R123 (115 + 8)
- You will still pay interest of R 8 to X bank, the only difference is the interest is not expensed to SPL, but capitalised to the cost price of the asset (SFP).

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Borrowing cost = Interest and other costs incurred in connection with the borrowing of funds (page 29 of study guide)
- To remember and to do in a question
 - ✓ *Calculate the total interest and other cost*



Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Loans and interest received (investment income)

To remember and to do in a question

- ✓ 3 Types of loans (funding sources)

Specific Loans

Example: Mortgage bond

Receive funds:

A – All funds when project commence

Borrowing cost = Actual cost on full loan **less investment income (interest received)**

B – In parts (progress payments)

Borrowing cost = Cost on progress payments

General Loans

Example: Bank overdraft

Borrowing cost =
Capitalisation rate x
expenditure on asset

Capitalisation rate = weighted
average rate of borrowings
(excluding specific
borrowings)

Borrowing cost capitalised
must < borrowing cost
incurred

General pool of funds

Example: > than 1 General loan

Borrowing cost = Capitalisation
rate x expenditure on asset

Capitalisation rate = weighted
average rate of borrowings
(excluding specific borrowings)
Borrowing cost capitalised must
< borrowing cost incurred

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- ✓ Capitalisation
 - By the bank or other financial institution
 - Capitalisation of borrowing cost towards the asset by the entity
- To remember and to do in a question
- Capitalisation (Compounding) by the bank =

When the bank calculates the interest on a loan, overdraft etc they calculate it on the loan plus interest

Example: A borrows R 10 000 from X Bank to construct an asset. X Bank charges interest at 12% per annum. Assume the loan is for two full years. The total interest for the period (Remember interest towards that bank is not necessarily = to borrowing cost capitalised) is as follow for the different scenarios:

A - BANK does not capitalise interest	
Year 1: $10\,000 \times 12\% =$	1 200
Year 2: $10\,000 \times 12\% =$	1 200
Total interest:	2 400

B - BANK capitalises interest annually	
Year 1: $10\,000 \times 12\% =$	1 200
Year 2: $11\,200 \times 12\% =$ ($10\,000 + 1\,200$ (Interest of year 1 capitalised by bank))	1 344
Total interest:	2 544

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

➤ Capitalisation (Compounding) by the bank (continue)

C - BANK capitalise interest monthly	
Year 1 - month 1: $10\,000 \times 12\% \times 1/12 =$	100
Year 1 - month 2: $10\,100 \times 12\% \times 1/12 =$ (capital of 10 000 + 100(Interest of previous month capitalised by bank))	101
Year 1 - month 3: $10\,201 \times 12\% \times 1/12 =$ (capital of 10 100 + 101(Interest of previous month capitalised by bank))	102
Year 1 - month 4: $10\,303 \times 12\% \times 1/12 =$ (capital of 10 201 + 102(Interest of previous month capitalised by bank))	103
Etc etc – you will continue with this calculation until the end of two years (24 months)	
Total interest: (Calculate it yourself and test the answer) The Total interest after 12 months (1 year) = 1 268	2 697

Please note the differences in the total interest (borrowing cost) for the three different scenarios.

You need to further note that this is the total interest that A will have to pay X Bank. This is not necessarily the total borrowing cost that will be capitalised towards the cost price of the asset.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

➤ Capitalisation of borrowing cost towards the asset by the entity

Cessation of capitalisation (stop to add borrowing cost towards the asset) =

WHEN ASSET IS READY FOR USE

Example: Use the same information as in the previous example (where capitalisation by the bank was explained). Additional to that, the asset that A constructed started on day one when the loan was received from x Bank. The asset was ready for use at the end of year 1. Assume all requirements of par .17 of IAS 23 were met (p31 study guide) on day one of loan.

A - BANK does not capitalise interest	
Borrowing cost capitalised towards asset (SFP) - from day one until ready for use (end of year 1)	1 200
Borrowing cost expensed in the SPL Total borrowing cost less portion to SFP (2 400 – 1 200)	1 200

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

➤ Capitalisation of borrowing cost towards the asset by the entity (continues)

B - BANK capitalises interest annually

Borrowing cost capitalised towards asset (SFP) - from day one until ready for use (end of year 1)	1 200
Borrowing cost expensed in the SPL Total borrowing cost less portion to SFP (2 544 – 1 200)	1 344

C - BANK capitalises interest monthly

Borrowing cost capitalised towards asset (SFP) - from day one until ready for use (end of year 1)	1 268
Borrowing cost expensed in the SPL Total borrowing cost less portion to SFP (2 697 – 1 268)	1 429

Remember! – This borrowing cost that is capitalised towards the cost price of the asset to the SFP. You will depreciate the asset (depreciation goes to the SPL). Eventually this borrowing cost originally allocated to the SFP will end up in the SPL.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Tax implications
 - ❑ **PRE-PRODUCTION INTEREST AS A DEDUCTION – WHEN ASSET IS BROUGHT INTO USE**
- To remember and to do in a question

Always ask yourself. What will I do for accounting purposes AND what will I do for tax purposes?
If there is a difference = **Deferred Tax!**

Accounting treatment:

Cost of asset (including borrowing cost capitalised) – depreciate over the useful life of asset from the date the asset is **ready to use**

Remaining interest will be deducted as an expense when the expense occurred

Therefore:

Your accounting profit will be reduced with:

- Depreciation
- Interest expense

VS

Tax treatment:

The borrowing cost will be deducted from taxable income from the date that the asset is **brought into use**

Therefore:

Your taxable income will be reduced with:

- Tax allowance on asset (wear&tear)
- Pre-production interest deduction

Both the above from the date the asset is brought into use.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Tax implications

☐ PRE-PRODUCTION INTEREST AS A DEDUCTION – WHEN ASSET IS BROUGHT INTO USE

Use the same information as in the previous example (example A). Assume the year end is December 2011 (also the end of year 1 of the 2 years). Assume the expenditure incurred to construct the asset were R 38 800 (cost of the asset before borrowing cost was capitalised). A depreciate the asset over 10 years. SARS allows a tax deduction on the asset of 20% a year (For this example: SARS does allow apportionment of the tax allowance).

Scenario 1 – The asset is ready for use and brought into use on 30 November 2011.

Deferred tax on 31 December 2011

	CA	TB	TD	Def tax @ 28%	A or L
Asset	39 568(1)	38 153 (2)	1 415	396	L
Pre-production interest (3)	-	-	-	-	

Calculations and notes:

(1) $[(38\ 800 + 1\ 200 \times 11/12) - ((38\ 800 + (1\ 200 \times 11/12))/10 \times 1/12)] = 39\ 568$

(2) $[38\ 800 - (38\ 800 \times 20\% \times 1/12)] = 38\ 153$

(3) As the asset was brought into use on/before year end, SARS allows the interest (1 200) as a deduction for the year ending December 2011

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Tax implications (continue)

Scenario 2 – The asset is ready for use on 30 November 2011 and brought into use on 1 January 2012.

Deferred tax on 31 December 2011

	CA	TB	TD	Def tax @ 28%	A or L
Asset	39 568(1)	38 800 (2)	768	215	L
Pre-production interest	-	1 200 (3)	1 200	336	A

Calculations and notes:

- (1) $[(38\,800 + 1\,200 \cdot 11/12) - ((38\,800 + (1\,200 \cdot 11/12))/10 \times 1/12)] = 39\,568$
- (2) The asset was brought into use after year end, therefore SARS did not allow any wear and tear deduction up to year-end.
- (3) As the asset was brought into use after year end, SARS will only allow the interest (1 200) as a deduction in the year it **was brought into use**, therefore the year ending December 2012

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Expenses incurred:
 - Beginning of period
 - Evenly over period
 - At the end of the period

To remember

This only has an effect on the calculation of interest.

Example: A incurred the following expenses to construct an asset:

Date/period	Expense
January (period 1)	5 000
February (period 2)	8 000
March (period 3)	6 500
Total	19 500

Note! This total expenses of R 19 500 = Cost price of asset(before borrowing cost is capitalised). You now need to calculate the Total interest, and then determine what part of the Total interest will be capitalised towards the cost price of the asset(SFP) and the part that will go to the SPL as an expense. (This part will not be done in this example, only the Total interest to explain the 3 different scenarios)

A make use of an overdraft facility to cover the expenses above. The bank charges interest at 10% per annum. The bank does not capitalise interest.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Expenses incurred (continue):
 - Beginning of period

Date/period	Expense	Calculation	Interest	Notes
January (period 1)	5 000	$(5\ 000 \times 10\% \times 1/12)$	41.67	1
February (period 2)	8 000	$(5\ 000 + 8\ 000) \times 10\% \times 1/12$	108.33	2
March (period 3)	6 500	$(5\ 000 + 8\ 000 + 6\ 500) \times 10\% \times 1/12$	162.50	3
Total	19 500		Total Interest 312.50	4

Notes:

1. Interest is calculated from day 1. The reason is A incurred the expenses on day 1 (beginning of the period), so A made use of the overdraft from day 1. The bank will charge A interest from the day they make use of there money.
2. The same explanation as in note 1 applies to the 8 000. A adds the 5 000 of the previous period as the expenses was already incurred, so A still owes the bank the money, so they will still charge A interest. A do not add the interest calculated in period 1 to the (5 000 + 8 000) when calculating interest for period 2. The reason = The bank does not capitalise interest.
3. Notes 1 and 2 applies here.
4. Remember this is total interest towards the bank. A now needs to determine what part should be **capitalised (towards the asset) SFP** and what part should be **expensed (SPL)**.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Expenses incurred (continue):
 - Evenly over period

Date/period	Expense	Calculation	Interest	Notes
January (period 1)	5 000	$(5\ 000/2 \times 10\% \times 1/12)$	20.83	1
February (period 2)	8 000	$(5\ 000 + (8\ 000/2)) \times 10\% \times 1/12$	75.00	2
March (period 3)	6 500	$(5\ 000 + 8\ 000 + (6\ 500/2)) \times 10\% \times 1/12$	135.42	3
Total	19 500		Total Interest 231.25	4

Notes:

1. Interest in period 1 is calculated on the expenses divided by 2. The reason is A incurred the expenses evenly over the period, therefore you take the average so you divide it by 2.
2. The same explanation as in note 1 applies to the 8 000. A adds the 5 000 of the previous period as the expenses were already incurred, so A owes the bank the full 5 000 on day 1 of period 2, so they will charge A interest on the full 5 000 in period 2. A do not add the interest calculated in period 1 to the $(5\ 000 + (8\ 000/2))$ when calculating interest for period 2. The reason = The bank does not capitalise interest.
3. Notes 1 and 2 applies here.
4. Remember this is total interest towards the bank. A now needs to determine what part should be **capitalised (towards the asset) SFP** and what part should be **expensed (SPL)**.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Expenses incurred (continue):
 - At the end of the period

Date/period	Expense	Calculation	Interest	Notes
January (period 1)	5 000		0	1
February (period 2)	8 000	$(5\,000 + 0) \times 10\% \times 1/12$	41.67	2
March (period 3)	6 500	$(5\,000 + 8\,000 + 0) \times 10\% \times 1/12$	108.33	3
Total	19 500		Total Interest 150.00	4

Notes:

1. No interest in period 1 is calculated. The reason is A incurred the expenses at the end of the period. The bank will charge A interest from the day they make use of their money, the last day of period 1. End of period 1 = beginning of period 2. The bank will therefore charge A interest on the 5 000 from period 2.
2. The same explanation as in note 1 applies to the 8 000. A adds the 5 000 of the previous period as the expenses were already incurred, so A owes the bank the full 5 000 on day 1 of period 2, so they will charge A interest on the full 5 000 in period 2.
3. Notes 1 and 2 apply here. A does not add the interest calculated in period 2 to the $(5\,000 + 0)$ when calculating interest for period 3. The reason = The bank does not capitalise interest.
4. Remember this is total interest towards the bank. A now needs to determine what part should be **capitalised (towards the asset) SFP** and what part should be **expensed (SPL)**.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Expenses incurred (continue):

Beginning of period:

Period 1: Calculate interest on expenses of period 1 from day 1

Period 2: Calculate interest on expenses of period 2 plus all expenses of previous period from day 1 of period 2.

Period 3 onwards: Calculate interest on expenses of this period plus all expenses of previous periods from day 1 of this period.

Evenly over period:

Period 1: Calculate interest on expenses of period $/2$ for the period.

Period 2: Calculate interest on expenses of period $/2$ plus all expenses of previous period from day 1 of period 2.

Period 3 onwards: Calculate interest on expenses of this period $/2$ plus all expenses of previous periods from day 1 of this period.

End of period:

Period 1: Calculate no interest.

Period 2: Calculate interest on expenses of period 1 from day 1 of period 2.

Period 3 onwards: Calculate interest on expenses of all previous periods from day 1 of this period.

Remember: This period can be one month, 3 months (a quarter), 10 days etc. For one month you use $1/12$ if a annual rate was given, $3/12$ for 3 months (a quarter) and $10/365$ for 10 days.

Borrowing Cost – IAS 23

Explanation of other rules, principles and scenarios that should be considered:

- Combination of funding sources (example loan and overdraft)

To remember

You will always use the funding source with the lowest interest rate first to incur expenditure, except if the question stipulates otherwise.

Disclosure (refer to study unit 3 in the study guide as well as IAS 23)

LEASES – IAS17

Operating Leases

- Ownership not transferred @ end
- Option to purchase at the end of the lease @ FV
- Not major part of asset's economic life
- Leased asset \neq specialised nature
- PV of min lease pmt's \neq +/- FV of asset

Finance Leases

- Ownership transferred @ end
- Option to purchase at the end of the lease $<$ FV
- Major part of asset's economic life
- Leased asset = specialised nature
- PV of min lease pmt's = +/- FV of asset

FINANCE LEASES - DISCLOSURE

LESSEE

- Asset + **Initial Direct Cost** = Addition in PPE
- Financial Liability
 - Non-current & Current
 - Reconciliation
 - Description lease
- Profit before tax
 - Depreciation
 - Interest expense

LESSOR

- Asset = Disposal in PPE
- Amount owed by lessee + **Initial Direct cost** = Financial asset
 - Non-current & Current
 - Reconciliation
 - Description lease
- Profit before tax
 - Finance Income
 - Profit on sale of machine

FINANCE LEASES – SPECIFIC ISSUES

- Initial Direct Cost
 - Add to the **ASSET** (Lessee – PPE; Lessor – Financial Asset)
- Depreciation (Lessee)
 - “If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term or its useful life”
- Residual values
- Deferred tax

FINANCE LEASES – TAX EFFECT

	Lessee	Lessor
Accounting:		
Income	N/A	<ul style="list-style-type: none"> - Finance income - Manufacturer profit - P/L if the asset was previously owned
Expenses	<ul style="list-style-type: none"> - Depreciation - Finance cost 	N/A
Tax:		
Taxable	N/A	Instalment
Deductions	Instalment	Wear and tear

FINANCE LEASE – LESSOR (Steps)

STEPS - PPE Note:

1. Determine the carrying amount of the asset to be finance leased, on the date of the commencement of the lease.
2. Dispose of the asset at carrying amount.

STEPS - PBT Note:

1. Calculate the “profit on sale” of the asset (Selling Price – CA)
2. Disclose the “profit on sale of asset”
3. Disclose the depreciation of the asset leased, up to the “lease commencement” date.
4. Disclose the interest income as per the amortisation table

FINANCE LEASE – LESSOR (Steps)

STEPS – Financial Asset Note:

1. Create an amortisation table:
 - a) Add the legal fees to the selling/lease price to determine a new PV.
 - b) Calculate the adjusted interest rate ($i = ? = 9.6666\%$ p.a.).
 - c) Determine whether the instalment dates are the same as the year-end dates.
 - d) If not, indicate the year-end dates, as well as the instalment dates in your table.
 - e) Ensure that the instalments are indicated against the instalment dates on the table
 - f) Interest should be calculated on the last **capitalised balance**.
 - g) Ensure the correct number of months is used when determining the interest for the various periods.

FINANCE LEASE – LESSOR (Steps)

STEPS – Financial Asset Note (continued):

2. Indicate the split between a non-current and current financial liability (use the information as at **year-end** from the amortisation table)
3. Disclose the “Investment in finance lease debtors”
 - Gross investment in finance lease debtors (GI)
 - Less: Unearned finance income (UFI)
 - Less: Short-term portion (GI and UFI portions)
4. Disclose the terms of the lease agreement
5. Disclose the “Reconciliation between the minimum lease payments and their present value”
 - Minimum lease payment
 - Finance Income
 - Present value

LEASES (LESSOR) - EXAMPLE

- Transactions:
 - YE is 31 December 2010
 - Reporting company: Plasticon Ltd
 - Container Ltd lease a machine from Plasticon Ltd from 1 July 2010
 - Open market value and selling price of machine: R1 100 000
 - Remaining useful life (at commencement of lease): 4 years
 - Nominal interest rate: 10.5% p.a.
 - Instalments payable annually in arrears: R350 781
 - Plasticon Ltd paid legal fees of: R 20 000
 - Machine originally acquired on 1 July 2008 @ R 1 200 000.
 - Depreciation: Over 6 years

LESSOR – AMORTISATION TABLE

Date	Interest Receivable	Capital repaid	Installment	Closing Balance
01/07/2010				1 120 000
31/12/2010	54 133	-	-	1 174 133
01/07/2011	54 133	242 515	(350 781)	877 485
31/12/2011	42 412	-	-	919 897
01/07/2012	42 412	265 957	(350 781)	611 528
31/12/2013	29 557	-	-	641 085
01/07/2013	29 557	291 667	(350 781)	319 861
31/12/2014	15 460	-	-	335 321
01/07/2014	15 460	319 861	(350 781)	-
	283 121	1 120 000	(1 403 124)	

LESSOR - PPE NOTE

Property, plant & equipment	Equipment Owned	Equipment Leased
Carrying amount at the beginning of the year	900 000	
Cost	1 200 000	-
Accumulated depreciation (1 200 000/6 * 18/12)	(300 000)	-
Depreciation for the year (1 200 000/6 * 6/12)	(100 000)	-
Transferred (to) / from finance lease asset	-	-
Disposals	(800 000)	-
Legal expense capitalised	-	-
Carrying amount at the end of the year		-
Cost	-	-
Accumulated depreciation	-	-

LESSOR - PROFIT BEFORE TAX

Profit before tax		R
Included in profit before tax are the following items:		
INCOME		
Profit on sales of asset	(1 100 000 – 800 000)	300 000
Interest income	Refer amortisation table	54 133
EXPENSE		
Depreciation	Refer PPE note	100 000

LESSOR - FINANCIAL ASSETS (part 1)

Financial Assets	
Non-current financial assets	
Loans and receivables	919 896
Current financial assets	
Loans and receivables (1 174 133 – 919 896)	254 237
Investment in finance lease debtors:	
Gross investment in finance lease debtor (350 781 x 4)	1 403 124
Less: Unearned finance income (283 124 – 54 133)	(228 991)
	1 174 133
Less: Short term portion	(254 235)
Gross investment in finance lease debtor (350 781 x 1)	350 781
Less: Unearned finance income (54 133 + 42 413)	(96 546)

LESSOR - FINANCIAL ASSETS (part 2)

Reconciliation of min lease pmt's to the PV thereof:			
	Up to 1 year	1 to 5 years	Total
Future min lease pmt's	350 781	1 052 343	1 403 124
Finance income	(96 545)	(132 446)	(228 991)
Present value	254 236	969 116	1 174 133

DESCRIPTION OF FINANCE LEASE DETAILS:

Plasticon Ltd is leasing a machine to Container Ltd from 1 June 2010.

Instalments of R350 781 is payable annually on 30 June for a period of 4 years
 etc. etc. etc.

MANUFACTURER / DEALER LESSORS

FINANCE LEASE

- Income:
 - Profit or loss from sale
 - Finance income
- Initial Direct Costs:
 - Expense at the commencement of the lease term
- Below market interest rate:
 - Selling profit is limited to the profit that would be applicable if a market related rate of interest was charged

SALE AND LEASEBACK - FINANCE

STEPS - PPE Note:

1. Account for asset under “owned assets” up to date of sale and leaseback (incl. depreciation)
2. Transfer @ CA from “owned asset” to “finance leased asset”
3. Under finance leased asset:
 - a) Account for CA of transferred asset
 - b) Make an adjustment to the CA to bring in line with the SP
 - c) Account for any initial direct costs.
 - d) Calculated depreciation on the “new cost” for the rest of the year up to YE

“new cost”

*PS: Depreciation to be accounted for over the **remaining** useful life of the asset*

SALE AND LEASEBACK - FINANCE

STEPS – Financial Liability Note:

1. Create a financial liability for the lease amounts (amortisation table)
2. Disclose non-current vs current
3. Disclose details of finance lease
4. Disclose reconciliation of min lease pmt's

STEPS – Deferred Profit Note:

1. Excess of SP over CA to be deferred and amortised over the **lease term**
2. Show portion credited to SCI for the year
3. Show balance to be credited in future years
4. Show balance to be credited in next 12 months (after YE)

STEPS – Profit Before Tax Note:

1. Deferred profit for the year (over lease term & proportionate to months up to YE)
2. Depreciation for the **entire** year (owned & leased) to be accounted for
3. Interest paid on the finance lease

LEASES - EXAMPLES

1. Finance leases – LESSOR

a) May 2011 EXAM: Question 3

2. Finance leases / Sale and leaseback finance lease - LESSEE:

a) October 2011 EXAM: Question 2

LEASES - EXAMPLES

- Transactions:
 - YE is 31 December 2010
 - Bought equipment on 30/06/2008 for R 1 300 000 (cash)
 - Commission of R26 000 was paid to Agent Ltd for negotiation of deal.
 - Sale & leaseback of equipment above on 1 May 2010 for R850 000
 - Terms of leaseback:
 - Term of lease: 3 years
 - Instalment: R175 583
 - Instalments to be made: Every 6 months
 - First payment: 31 October 2010
 - Last payment: 30 April 2013
 - Nominal interest rate: 13.00%
 - Effective interest rate: 13.42%
 - Ownership will be transferred at the end of the lease @ zero cost
 - Legal fees of R15 000 were paid for finalising the lease

PPE NOTE

Property, plant & equipment	Equipment Owned	Equipment Leased
Carrying amount at the beginning of the year	928 200	
Cost (1 300 000 + 26 000)	1 326 000	
Accumulated depreciation (1 326 000 x 20% x 18/12)	(397 800)	
Depreciation for the year [(1 300 000 + 26 000) x 20% x 4/12] [(839 800 + 10 200 + 15 000) / 38 x 8]	(88 400)	(182 105)
Transferred (to) / from finance lease asset	(839 800)	839 800
Adjustment to carrying amount of asset (850 000 – 839 800)		10 200
Legal expense capitalised		15 000
Carrying amount at the end of the year	-	682 895
Cost	-	865 000
Accumulated depreciation	-	(182 105)

“New Cost”

PROFIT BEFORE TAX

Profit before tax		R
INCOME		
Deferred profit – Amortised	$[(850\,000 - 839\,800)/36 \times 8]$	2 267
EXPENSE		
Depreciation	$[((1\,300\,000 + 26\,000) \times 20\% \times 4/12) + (865\,000 / 38 \times 8)]$	270 505
Interest paid on finance sale and leaseback agreement	$(55\,250 + 15\,809)$	71 059

FINANCIAL LIABILITIES (part 1)

Financial liabilities at amortised cost	
Non-current financial liabilities	
Financial liabilities measured at amortised cost	475 103
Current financial liabilities	
Financial liabilities measured at amortised cost (745 476– 475 103)	270 373

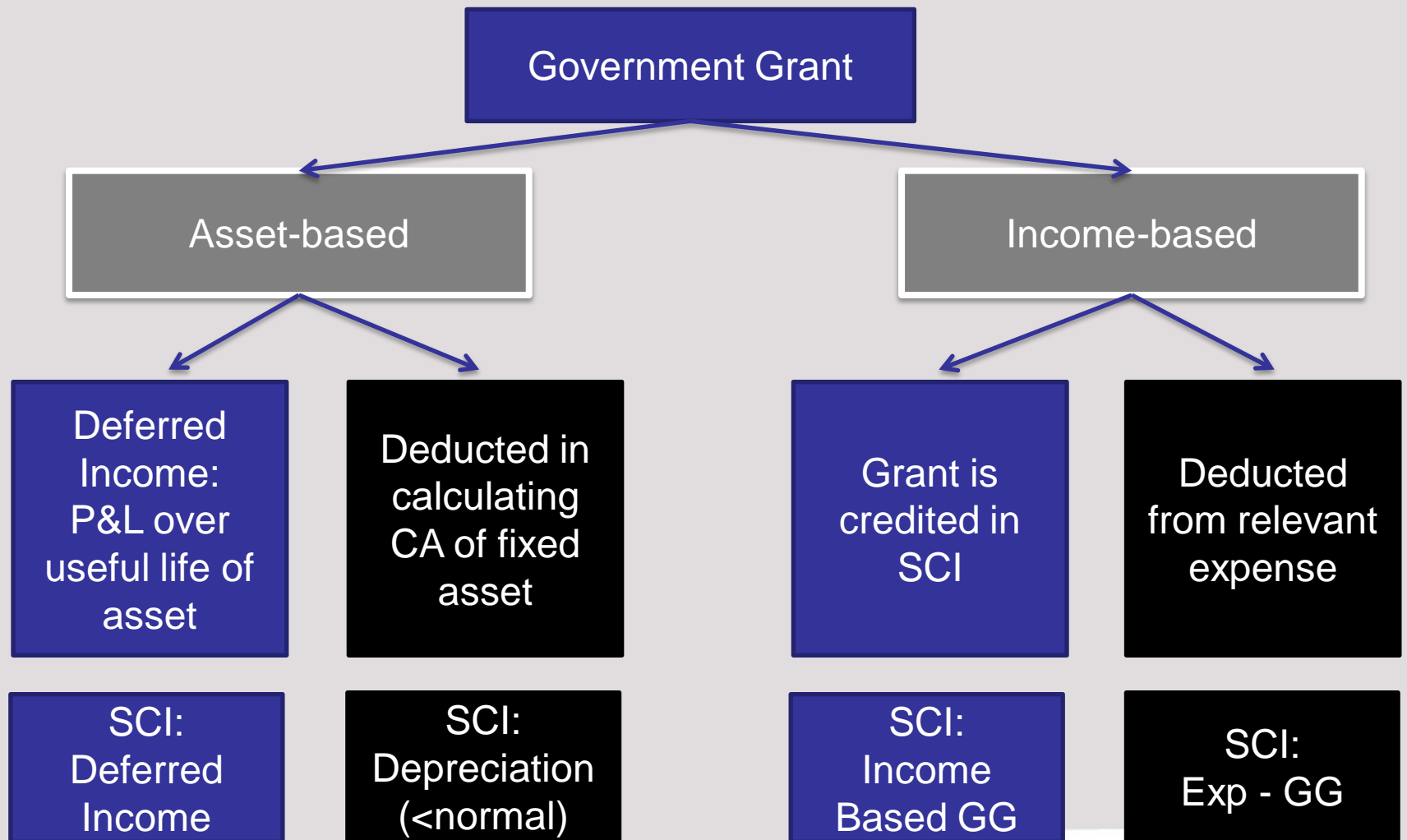
FINANCIAL LIABILITIES (part 2)

Reconciliation of min lease pmt's to the PV thereof:			
	Up to 1 year	1 to 5 years	Total
Future min lease pmt's	351 166	526 749	877 915
Finance cost	(80 793)	(51 646)	(132 439)
Present value	270 373	475 103	745 476
DESCRIPTION ON FINANCE LEASE DETAILS:			
XXXXX			

DEFERRED INCOME

Deferred Profit	
DESCRIPTION OF SALE & LEASEBACK DETAILS	
XXXXXX	
The movement on the deferred profit account is as follows:	
Profit on sale and lease back agreement	10 200
Credited to profit for the year	(2 267)
Balance of deferred profit to be credited to profit in the future	7 933
Less: Short-term portion (10 200 x 12/36)	(3 400)
	4 533

GOVERNMENT GRANT – IAS20



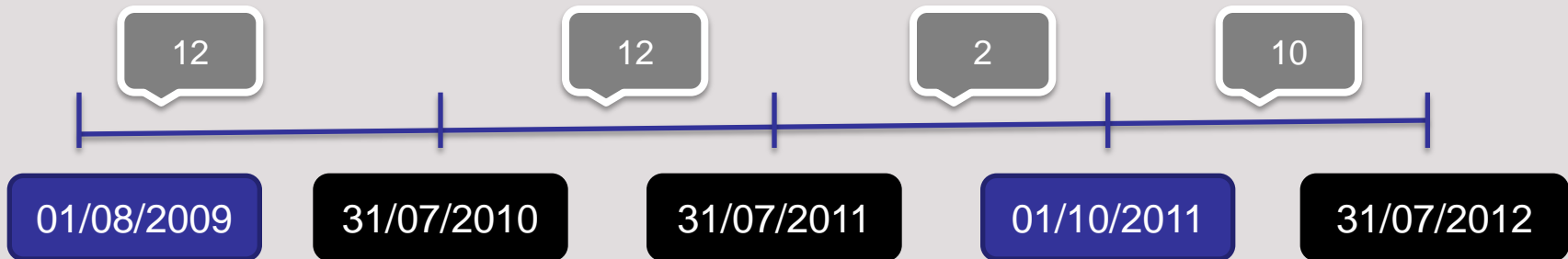
GOVERNMENT GRANT - REPAYMENT

REPAYMENT:

Adjustment to be made in **current** financial year, in order to bring the amount recognised, in line with what the **accumulated total amount** being accounted for up to year-end would have been, if the grant was repaid on the date that the original grant was received!!!!

GG REPAYMENT - EXAMPLE

- Received grant: R 2 000 000 on 1 August 2009
- Repayment of grant: R 500 000 on 1 October 2011
- Year-end: 31 July 2012
- Grant period: 5 years



Recognised up to 31/07/11: $R\ 2\ 000\ 000/60 \times 24\ \text{months} = R800\ 000$

Recognised 01/08/11 – 01/10/11: $R\ 2\ 000\ 000/60 \times 2\ \text{months} = \underline{R\ 66\ 667}$
 R866 667

Should have been based on R1 500 000:

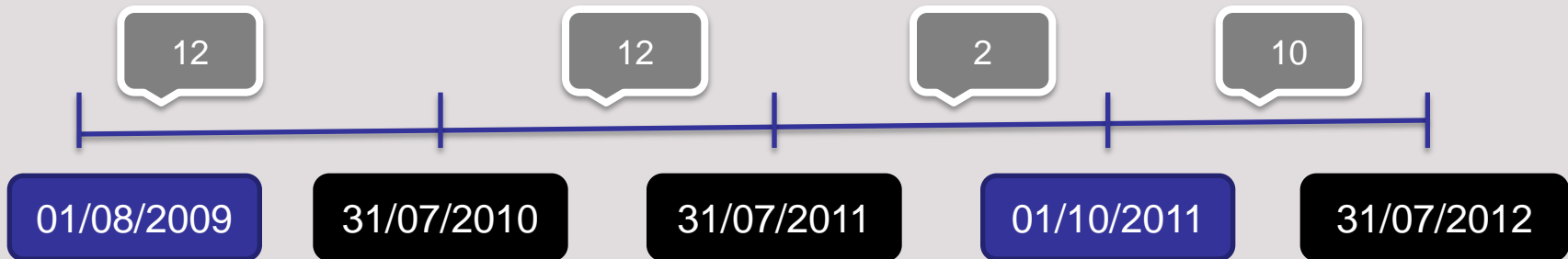
Recognised up to 31/07/11: $R\ 1\ 500\ 000/60 \times 24\ \text{months} = R600\ 000$

Recognised 01/08/11 – 01/10/11: $R\ 1\ 500\ 000/60 \times 2\ \text{months} = \underline{R\ 50\ 000}$
 R650 000

Adjustment up to 01/10/2011 = R216 667

GG REPAYMENT - EXAMPLE

- Received grant: R 2 000 000 on 1 August 2009
- Repayment of grant: R 500 000 on 1 October 2011
- Year-end: 31 July 2012
- Grant period: 5 years



GG to be accounted for 01/10/2011 – 31/07/2011:

$$R1\ 500\ 000 / 60 * 10\ \text{months} = R\ 250\ 000$$

To be recognised in SCI:

1. GG up to 01/10/2011	R 66 667	
2. Adjustment as calculated	(R 216 667)	<i>Over accounted for in PY</i>
3. GG 01/10/11 – 31/07/2012	<u>R 250 000</u>	
	<u>R 100 000</u>	

GG REPAYMENT – EXAMPLE ALT CALC

- Received grant: R 2 000 000 on 1 August 2009
 - Repayment of grant: R 500 000 on 1 October 2011
 - Year-end: 31 July 2012
 - Grant period: 5 years
-

Alternative calculation:

Recognised on R2m up to 31/07/11: $R\ 2\ 000\ 000 / 60 \times 24\ \text{months} = R\ 800\ 000$
Should have on R1.5m to 31/07/11 : $R\ 1\ 500\ 000 / 60 \times 24\ \text{months} = \underline{R\ 600\ 000}$
Adjustment (beginning of fin year) R 200 000

To be accounted for in 2012 fin year:

GG on new balance (for full year) $R\ 1\ 500\ 000 / 60 \times 12 = R\ 300\ 000$
Adjustment up to beginning of fin year $= \underline{-(R\ 200\ 000)}$
R 100 000

GOVERNMENT GRANT

- Remember:
 - Indicate whether a grant is **income** or **asset** based!! Marks are sometimes given for descriptions.
The information is given in the exam question (normally stipulated in the accounting policy)
 - Adjustment for prior year over or under provision is to be made in current financial year

Segment Reporting – IFRS 8

1. Concept/Basic explanation of segment reporting

The standard specifies how an entity should report information about its reportable segments, and what should be reported.

Reportable segment = Operating segments as a result of:

- ❖ Definition of an operating segment par 7.4(P167 E guide, BI 170 A gids) **AND**
- ❖ Quantitative thresholds par 7.7 (P167 E guide, BI 170 A gids)

In my own words – You report on the financial information of an entity as a whole that consists out of more than one segment/component/section that also report their own information on their own ways (management reports etc). There is certain related disclosure requirements about products and services, geographical areas, major customers and reconciliations between segments and the entity as a whole that should be adhered to.

PS! – This is a short, simple description. Unfortunately there is certain rules that you should first study, for example what is an operating segment, what is the quantitative thresholds etc. Refer to study unit 7 in the study guide as well as IFRS 8.

Segment Reporting – IFRS 8

You should now understand the basic principle of IFRS 8. As with all accounting standards, there are different rules/principles that should be applied, depending on the scenario:

Other rules, principles and scenarios that should be considered:

(These are only a few students normally struggle with. For completeness, refer to study unit 7 in the study guide as well as IFRS 8

- Reconciliations
- Disclosure (refer to par 7.12 (P169 – p171 E guide, BI 173 – BI 174 A gids) in the study guide as well as IFRS 8)

Segment Reporting – IFRS 8

Explanation of other rules, principles and scenarios that should be considered:

- Reconciliations

To remember

The reconciliation is to compare the financial information (Revenue, profit or loss, assets or liabilities) of the whole entity with the information of the operating segments. The differences are referred to as adjustments/reconciling items. Examples of situations that normally result in differences are:

- Cash vs Accrual basis of preparation - The one prepares its financial information on the cash basis and the other on the accrual basis.
- Intersegment transaction – The segment will show for example its profit from sale towards another segment while the entity as a whole excludes it.
- Any other additional information given in a question.

Example: A LTD has two reportable operating segments, Segment 1 & Segment 2. Both segments report their results, assets and liabilities to the chief operating decision making officer on the cash basis for decision making purposes. The details of A, as well as Segment 1 & 2 for the year end 31 December 2011, before additional information is taken into account, are as follows:

PS! Remember in this example the segments report on the cash basis. They can also report on the accrual basis, depending on the policy of the company. So read carefully what the question stipulates.

Segment Reporting – IFRS 8

Explanation of other rules, principles and scenarios that should be considered:

- Reconciliations (continue):

	A LTD	Segment 1	Segment 2	Total segments
Profit before tax	350 000	112 640	224 360	337 000
Trade debtors (Dec 2011)		18 200	18 790	36 990
Trade debtors (Dec 2010)		6 200	7 350	13 550
Trade creditors (Dec 2011)		6 500	5 820	12 320
Trade creditors (Dec 2010)		2 430	2 450	4 880

Additional information not yet taken into account above

1. Segment 1 paid interest of R 9 100 on 31 December 2011 on an outstanding loan.
2. Segment 2 sold certain of its items to Segment 1 during the 2011 financial year. The total of these items that were sold are included as inventory on hand for the year end 31 December 2011. This part of the inventory of Segment 1 equals to R15 000, the price segment 2 sold it for to segment 1. Segment 2 sells all items at cost price plus 25%.
3. The only assets that the entity owns is a vehicle. The cost price of the vehicle is R100 000. It was purchased in 2010. The useful life of the vehicle is 5 years.
4. Segment 1 provide for a bonus provision of R 85 000 on 31 December 2011. The bonus provision on 31 December 2010 were R79 250

Segment Reporting – IFRS 8

Explanation of other rules, principles and scenarios that should be considered:

- Reconciliations (continue):

Required

Prepare the reconciliation between the segment information and the line items in the statement of profit or loss and other comprehensive income with regards to profit before tax as it would appear in the operating segment note in the notes to the annual financial statements of A LTD for the year ended 31 December 2011.

Answer (next page)

Segment Reporting – IFRS 8

Explanation of other rules, principles and scenarios that should be considered:

- Reconciliations (continue):

Answer

A LTD

Notes for the year ended 31 December 2011

Reconciliation of total segment profit before tax to entity profit before tax

	Calculations	Explanatory notes	R
Total segment profit before tax	(337 000 – 9 100)	1	327 900
Adjustments			(12 750)
<i>Increase in trade debtors</i>	(36 990 – 13 550)	2	23 440
<i>Increase in trade creditors</i>	(12 320 – 4 880)	3	(7 440)
<i>Profit on intersegment inventory on hand on 31 December 2011</i>	(15 000/125x25)	4	(3 000)
<i>Depreciation</i>	(100 000/5)	5	(20 000)
<i>Short term employee benefits accrued - 31 Dec 2011</i>		6	(85 000)
<i>Short term employee benefits accrued - 31 Dec 2010</i>		6	79 250
Profit before tax as per statement of profit or loss and other comprehensive income	Refer to calc 1 below	7	315 150

Segment Reporting – IFRS 8

Explanation of other rules, principles and scenarios that should be considered:

- Reconciliations (continue):

Calculation 1 (Profit before tax to take additional information into account)

	Calculations	R
Profit before tax (given)		350 000
Less: Interest paid	Given	(9 100)
Less: Depreciation	(100 000/5)	(20 000)
Less: Employee benefits	(85 000 – 79 250)	(5 750)
Profit before tax (after additional information)		315 150

Explanatory notes:

1. The total segment profit given needs to be adjusted with all cash items in the additional information. The only cash item was interest **paid**.
2. Add the increase in trade debtors. Why? = The segments report only cash sales. So if debtors have increased from one year to another, it means there was credit sales (Dr debtors Cr Sales). So it was not accounted for by the segments, so this will be an adjustment/reconciling item. When debtors decrease, you will deduct that amount.
3. Deduct the increase in trade creditors. Why? = The segments only report cash expenses/purchases incurred. So if creditors have increased from one year to another, it means there was credit purchases (Dr purchases Cr creditors). So it was not accounted for by the segments, so this will be an adjustment/reconciling item. When creditors decrease, you will add that amount.

Segment Reporting – IFRS 8

Explanation of other rules, principles and scenarios that should be considered:

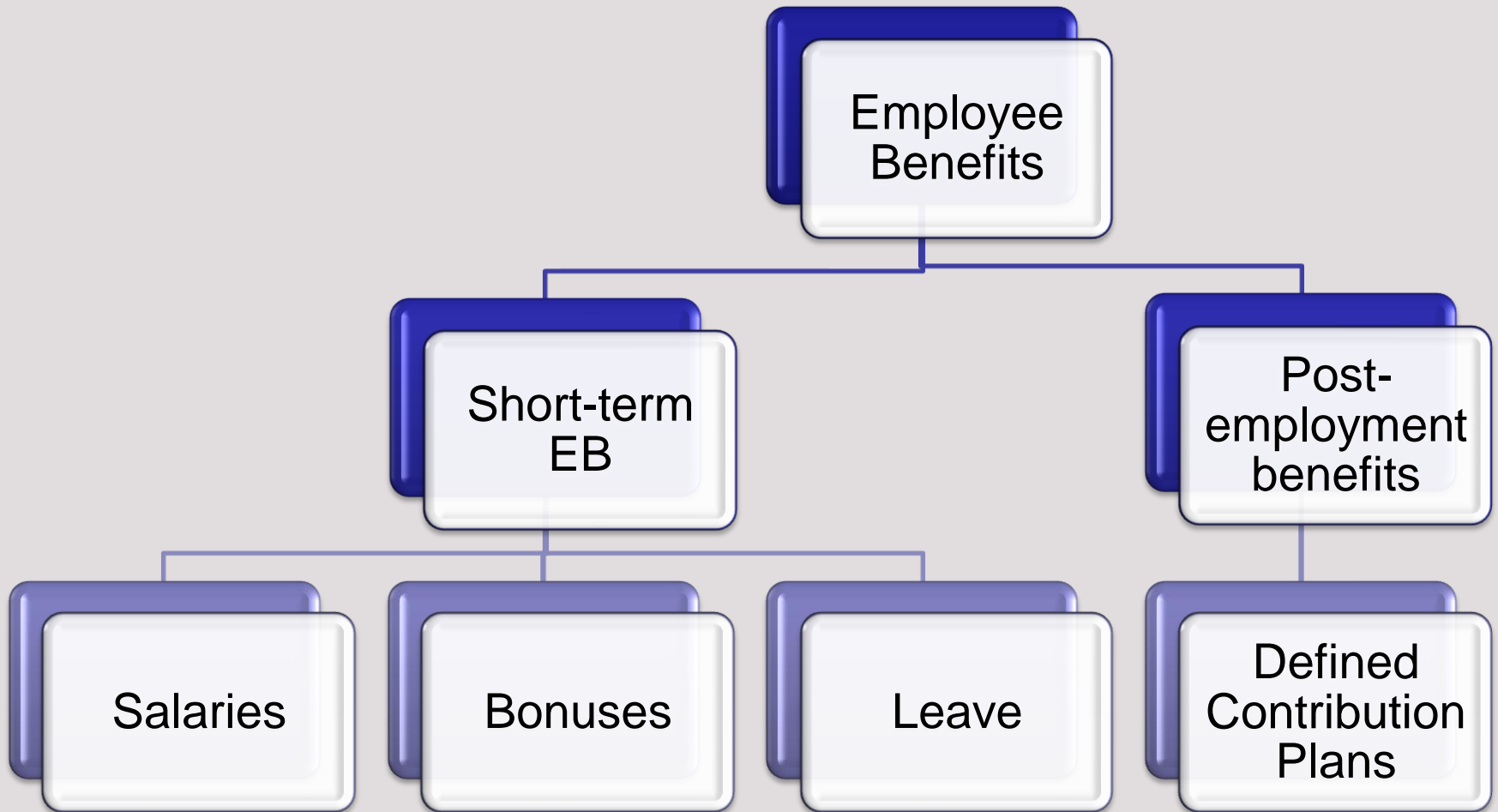
- Reconciliations (continue):

Explanatory notes(continue):

4. The profit on intersegment transactions should be eliminated. Why = It is not a “true” profit for the entity as a whole. So the information given are that Segment 1 has inventory of R 15 000 purchased from Segment 2 on hand at year end. Segment 2 charge cost plus 25%.
Cost (100%) plus profit (25%) = Total (125%)
You need the profit = 25
You have total = 125 = R 15 000
Therefore: $15\ 000/125 \times 25 = 3\ 000$
PS! No adjustment to the entity as a whole. Why? = The sales of Segment 2 = R 15 000 and the cost of Segment 1 = R 15 000. The net effect for the entity is zero.
5. Depreciation is a non-cash item. The segments reports on the cash basis, so depreciation was not accounted for. It is therefore an adjustment/reconciling item.
6. The bonus accrual is not a cash item. So you need to deduct the current year balance for the segments, and add back the prior year balance. Why? = This movement is an expense. The entity as a whole would have accounted for it (employee benefit cost)as they report on the accrual basis. The segments on the other hand only reports on the cash basis, so this employee benefit accrual was not accounted for. It is therefore an adjustment/reconciling item.
7. Profit for the entity needs to be recalculated. Why? = We gave you the profit before tax and then gave you additional information. Remember the information given in a question can differ. For example we could have said the profit before tax for A LTD already includes additional information. No adjustment is then needed. So read the question and then think logically!

RECON VS CALC!!!

EMPLOYEE BENEFITS – IAS19



EMPLOYEE BENEFITS

STUDENTS STRUGGLE WITH THE FOLLOWING:

- Monthly vs annual salary amounts
- Salary increases during the year
- Bonus provision
- **Leave provision**

EMPLOYEE BENEFITS

Salaries & Bonus Example:

Average monthly salaries paid in cash during the 6 months ended 31 July 2011 were R132 000. The employees received their annual increase (an average of 10% per annum for 2011) from 1 Feb 2011. Annual bonuses equal to 1 month's salary and based on the December salaries were paid at the end of Dec of each year. Year-end is 31 July 2011.

Salaries:

01/06/2010 – 31/01/2011	$(R132\ 000 \times 100/110) \times 6\ \text{months}$	= R 720 000
01/02/2011 – 31/07/2011	$R\ 132\ 000 \times 6\ \text{months}$	= <u>R 792 000</u>
		<u>R1 512 000</u>

Bonus:

Paid on 31 Dec 2010	$(R132\ 000 \times 100/110)$	= R 120 000
Prior year provision	$(R132\ 000 \times 100/110) \times 7/12$	= (R 70 000)
Current year provision	$(R132\ 000 \times 7/12)$	= R 77 000

Employee Benefits

Leave Example:

NB: Leave is paid out at the rate as applicable at **payment date, not the average rate up to that point!!**

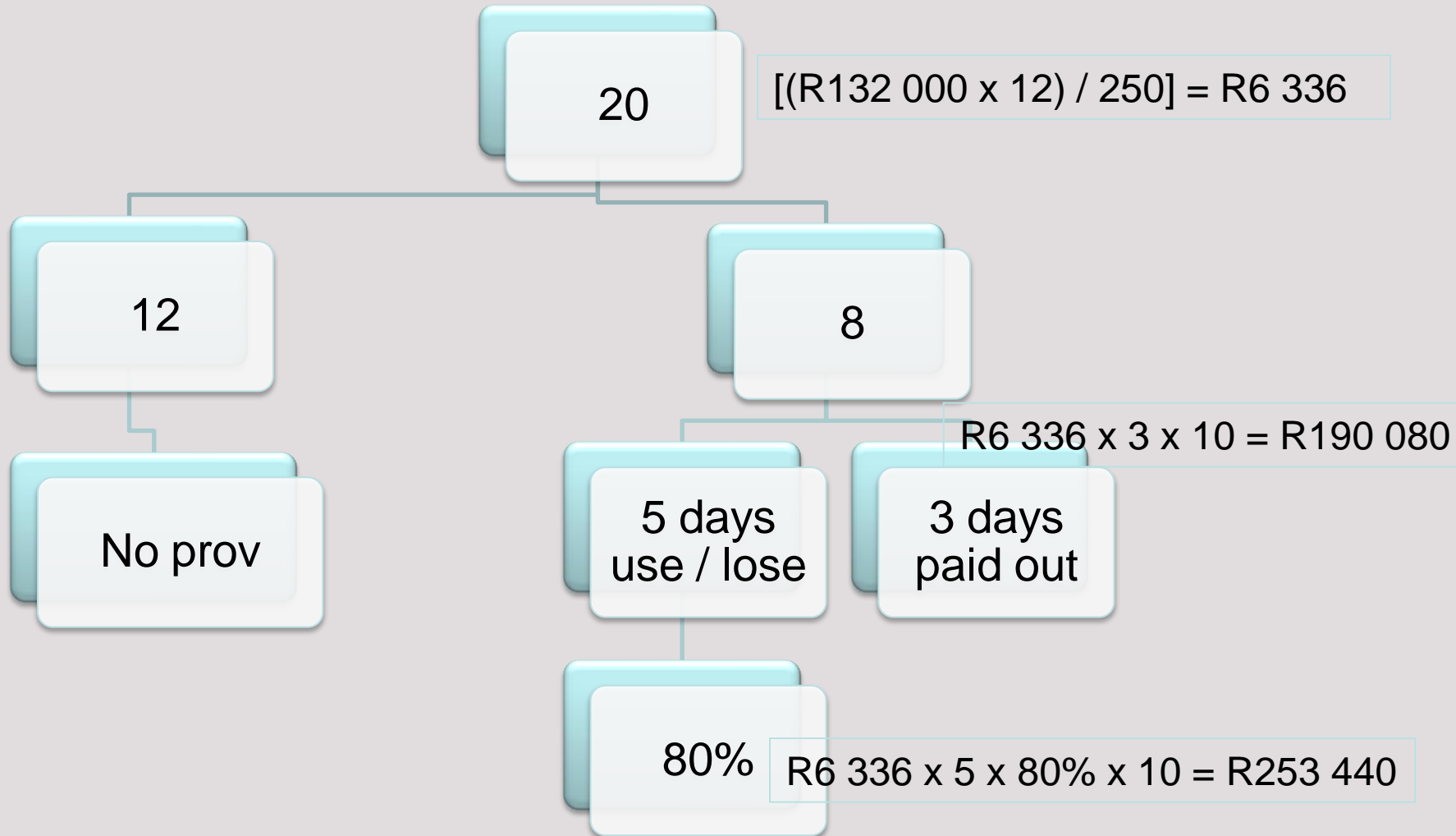
All employees are entitled to 20 working days leave for a financial year. They have to take a minimum of 12 working days leave per annum. The remaining 8 days can be transferred. 3 of these days can be accumulated to be paid out on retirement / resignation from the company. 5 days can be transferred to be used in following year and will be lost if not taken in that year. There are 250 working days in the year.

Prior experience has shown that only 80% of the employees use the days transferred to the next year during that year. There are 10 employees. (Assume for this example that the R132 000 salary is not for the entire company, but per employee per month)

What is a leave provision?

You provide for future “costs” to the company that relates to either leave taken in “another year” or money that need to be paid out!

EMPLOYEE BENEFITS



EMPLOYEE BENEFITS

Leave Provision:

$$\#1. [(R132\ 000 \times 12) / 250] = R6\ 336 \text{ per day}$$

$$\#2. R6\ 336 \times 3 \times 10 = R190\ 080 \quad \text{“Paid out”}$$

$$\#3. R6\ 336 \times 5 \times 80\% \times 10 = \underline{R253\ 440} \quad \text{“Use / lose”}$$
$$= \underline{R443\ 520}$$

Remember:

1. What is your daily rate per employee at year-end?
2. You can only provide for your expected future cost (80% etc.)
3. How many employees, at what rates?
4. How many days per employee?
5. Reverse prior year provisions

Earnings per share – IAS 33

1. Concept/Basic explanation of earnings per share

Earnings per share and dividends per share are two of the ratios that are most widely used by investors and analysts of financial statements when evaluating the profitability of a company. It is therefore essential that guidelines should be laid down for the calculation and disclosure of earnings and dividends per share and, where applicable, fully diluted earnings per share in order to make it easier to compare these ratios.

In my own words – The names says it all, earnings per share and dividend per share. Then with a few adjustments on earnings per share you get headline earnings per share and diluted earnings per share.

PS! – This is a short, simple description. Unfortunately there is a lot of rules that you should first study, for example the formulas at rights issue, calculation of weighted average number of shares(when to adjust prior years and when not etc), what to include and exclude in diluted earnings per share etc. Refer to study unit 5 in the study guide as well as IAS 33.

Earnings per share – IAS 33

You should now understand the basic principle of IAS 33. As with all accounting standards, there are different rules/principles that should be applied, depending on the scenario:

Other rules, principles and scenarios that should be considered:

(These are only a few students normally struggle with. For completeness, refer to study unit 5 in the study guide as well as IAS 33

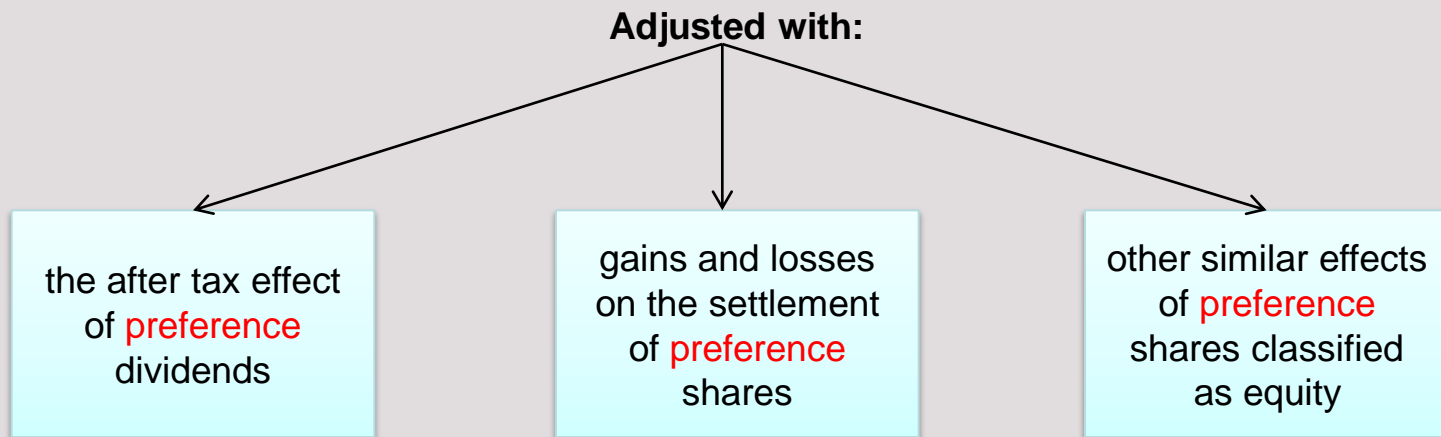
- Basic earnings per share
 - a) Earnings
 - b) Shares
- Different classes of shares
- Changes in capital structure
- Diluted earnings per share
 - a) Convertible instruments
 - b) Options, warrants and other share purchase agreements
 - c) Contingently issuable shares
 - d) Financial instruments
 - e) Options
 - f) Sequence of dilution
- Headline earnings
- Dividends per share
- Disclosure (refer to par 7.12 (P169 – p171 E guide, BI 173 – BI 174 A gids) in the study guide as well as IFRS 8)

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

$$\text{Basic earnings per share} = \frac{\text{Profit or loss (after tax) attributable to ordinary equity holders of the parent entity ("earnings")}}{\text{Weighted average number of ordinary shares outstanding during the period}}$$

- a) **Earnings** = Profit or loss (**after tax**) attributable to ordinary equity holders of the parent entity ("earnings")



Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

Shares = Weighted average number of shares

Weighted average number of shares = the number of ordinary shares outstanding at the beginning of the period, **adjusted** by the number of ordinary shares **bought back or issued** during the period multiplied by a **time-weighting** factor.

PS!

- Shares outstanding = shares issued
- The time weighting factor = number of days that the specific shares are outstanding(issued) as a proportion of the total number of days in the period.

Example(illustrate basic earnings per share):

The profit before tax of A limited for the year ending 31 December 2011 equals to R 163 399. A Ltd has 25 000 ordinary shares and 1 000 10% cumulative preference shares (amounting to R 50 000) in issue on 1 January 2011. A Ltd issue a further 20 000 ordinary shares on 1 July 2011. Assume a SA normal tax rate of 28%. The non-controlling interest equals to 15%.

Required: Calculate the basic earnings per share for the year end 31 December 2011

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

Example(illustrate basic earnings per share): continue

Step1: Calculate **basic earnings**

	Calculations	R
Profit for the year (given)		163 399
Income tax expense	(163 399 x 28%)	<u>(45 752)</u>
Profit after tax		117 647
Less - Non-controlling interest	(117 647 x 15%)	<u>(17 647)</u>
Profit to owners of the parent		100 000
Less: preference dividends	(50 000 x 10%)	<u>(5 000)</u>
Basic earnings		95 000

Step2: Calculate **weighted average number of shares**

Original number of shares (1 January 2011)		25 000
Shares issued on 1 July 2011	(20 000 x 6/12)	<u>10 000</u>
Weighted average number of shares		35 000
Therefore: Basic earnings per share =	(95 000 / 35 000)	R2,71

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- Different classes of shares (Refer to examples 6 – 8 in study guide)

Participating preference shares

Participating preference shares are shares whose holders are entitled, in addition to receiving their fixed preference dividend, to share along with the ordinary shareholders in the remainder of the distributable profit, **either pro rata or after ordinary shareholders have received a certain minimum dividend**. It is important to take careful note of the conditions of issue and of the capital structure.

A. Pro rata = Calculate the percentage (participating rights) that will be allocated to ordinary shareholders and preference shareholders

Pro rata can for example be:

- a) Condition of preference share (**per share**) = one cent **per share** to every four cents **per share paid to ordinary holders (Example 6 in study guide)**
(You multiply the cents given per class with the number of shares per class. The rand per class/total rand of all classes = % participation)
- b) Condition of preference share (**total**) = preference shareholders would share **in total** in the profits of the company at a ratio of one cent for every four cents that the **ordinary shareholders in total** are entitled to (**Example 6 in study guide**) (You multiply the cents given per ordinary with the number of shares per ordinary. You then divide this total by 4 and multiply by 1. (continue on next page)

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- Different classes of shares (continues)

If the question stipulated “.... at three cents for every ten cents”, you will divide the total by 10 and multiply by 3. etc etc. So read the information given in the question properly and calculate the percentage according to that information. The rand per class/total rand of all classes = % participation)

B. After ordinary shareholders have received a certain minimum dividend = You use the pro rata/% participation on the profit after this minimum dividend was deducted.

For example. You have calculated the participation rights as 90% towards ordinary shares, and 10% towards preference shares. Profit after tax for A Limited equals R 180 000. Fixed preference dividend for the year equals R 50 000. Preference shareholders share in profits after a minimum dividend of R 30 000 (5 cent per share) is paid to the ordinary shareholders. An ordinary dividend of 7 cents per share was paid during the year. For dividends, assume each participating preference share is entitled to half of the ordinary dividend per share and there is 300 000 preference shares.

For earnings = You will deduct the preference dividend and minimum dividend from the profit after tax (180 000 – 50 000 – 30 000) to get the earnings (100 000) that needs to be split towards ordinary (90%) and preference (10%) shareholders.

For dividends = dividend share ratio x number of preference shares x (ordinary div/share – minimum div/share)
= $\frac{1}{2} \times 300\,000 \times (7c - 5c)$

Refer to example 8 in the study guide

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- **Changes in capital structure**

- A. Shares issued for consideration (with a change in resources)
- B. Shares issued for no consideration (without a change in resources)

- A. Shares issued for consideration (with a change in resources)**

Refer to examples 9 – 12 in the study guide

Shares are **included** in the weighted average number of shares from the **date consideration is receivable**. The number of shares in issue in the **previous year must not be weighted**.

The reason why the shares of the previous year are not weighted is because the consideration for the additional shares is received in the current year and therefore does not influence the calculation of the number of shares of the previous year.

Refer to table of examples to explain when is “date consideration is receivable” P99 E guide, BI 100 A gids)

Ordinary shares which are issuable upon the satisfaction of certain conditions (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions have been satisfied.

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- **Changes in capital structure (continue)**

B. Shares issued for no consideration (without a change in resources)

Refer to examples 13 – 17 in the study guide

The weighted average number of ordinary shares outstanding during the period, **and for all periods presented**, should be adjusted for events that have changed the number of ordinary shares outstanding without a corresponding change in resources. (This will exclude conversion of potential ordinary shares.)

Examples of shares issued without a change in resources:

- a) Capitalisation or bonus issues (Example 13 & 14 in study guide)

= **Ordinary** shares are issued to **existing** shareholders for **no additional consideration**.

Weighted average no of shares adjustment = The number of ordinary shares outstanding before the event is adjusted for the proportionate change (depending on info in question) in the number of ordinary shares outstanding as if the event had occurred at the beginning of the earliest period presented (in other words comparative figure/prior year is also adjusted).

PS! Refer to example 14 where more than one change in capital structure occurs. You need to do it step by step, according to dates of transactions.

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

B. Shares issued for no consideration (without a change in resources) (continue)

b) Share split (Example 16 in study guide)

Treatment = capitalisation or bonus issue (refer to (a))

c) Consolidation of shares (Example 17 in study guide)

= **Ordinary** shares **reduces** the number of ordinary **shares** outstanding **without** a corresponding **reduction** in **resources**.

Weighted average no of shares adjustment = earnings per share is based on the decreased number of ordinary shares after the share consolidation took place and **comparatives (in other words comparative figure/prior year is also adjusted) are proportionately (depending on info in question) adjusted.**

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

B. Shares issued for no consideration (without a change in resources) (continue)

d) Rights issue (Example 15 in study guide)

Rights issue at fair value = treated in the same way as a new issue.

Rights issue at less than the fair value = involves two components:

- an issue of shares for full value
- and a bonus issue

= **Ordinary** shares for all periods prior to the rights issue is the number of ordinary shares outstanding prior to the issue, multiplied by the following factor:

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

Theoretical ex-rights fair value per share =

Aggregate fair value of shares immediately prior to the exercise of rights + proceeds from the exercise of rights

Number of shares outstanding after the exercise of the rights

OR

Fair value of outstanding shares + amount received from rights issue

Number of shares outstanding prior to the rights issue + number of shares issued with rights issue

For all periods after the rights issue, add the total number of share issue proportioned to the period.

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- **Diluted earnings per share (Examples 20 – 27)**

= basic earnings per share adjusted with future changes in the capital structure of the enterprise.

Dilution = reduction in earnings per share (or an increase in loss per share) resulting from the assumption that:

- convertible instruments are converted,
- options or warrants are exercised, or
- ordinary shares are issued upon the satisfaction of specified conditions.

In other words:

Basic earnings per share = $\text{Earnings} / \text{Weighted average number of ordinary shares outstanding during the period}$

If something in future will effect either the earnings, or the weighted average number of shares, or both, and the result is lower than basic earnings per share, the effect is dilutive.

Example: Convertible debentures (into 100 shares after two years). Currently you pay interest on the debentures and you do not have shares. In future if you convert them into shares, you will save the interest (so your profit will increase) and you will have more shares (weighted number of shares also increase). You now need to determine whether the effect is dilutive or anti-dilutive.

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- **Diluted earnings per share (Examples 20 – 27) (continue)**

Steps to follow with diluted earnings per share

1. Calculate Basic earnings per share
2. Identify all instruments that might in future lead to a change in capital structure (options, convertible debentures etc)
3. Identify the future impact on the earnings (Numerator) (example: options no effect, convertible debentures = saving of interest paid)
4. Identify the future impact on the weighted average number of shares (Denominator) (example options will have an effect, convertible debentures will have an effect)
5. Now determine the order of dilution. Take all instruments identified (step 2) and calculate the earnings per share of that specific instrument (on a line by line basis)
= (Effect on earnings) divided by (effect on weighted average number of shares).
6. The lowest result in step 5 will be number 1, second lowest number 2 etc.
7. Determine if potential ordinary shares are dilutive or not.
 - a) Start with basic earnings per share then;
 - b) Adjust the earnings and weighted number of shares of basic earnings per share with number 1 identified in the order of dilution identified in step 5 & 6. If the result < than basic earnings per share = dilutive, if the result > basic earnings per share = anti-dilutive
 - c) Adjust the **new (as calculated in 7 (b))** earnings and weighted number of shares with number 2 (next number) identified in the order of dilution identified in step 5 & 6. If the result < than earnings per share **(as calculated in 7 (b))** = dilutive, if the result > earnings per share **(as calculated in 7 (b))** = anti-dilutive
 - d) Continue like this until all instruments identified in step 2 was considered.
8. **The last item that is dilutive will be your diluted earnings per share.**

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- **Headline earnings**

To be meaningful the headline earnings should be based on earnings that reflect the underlying operating/trading performance of an entity. Distinction must therefore be made between the transactions influencing the operating/trading performance of an entity and the capital transactions that reflect and affect the resources (capital platform) committed in producing the operating/trading performance. Only the transactions influencing the operating/trading performance of the company will be included in headline earnings. Developments such as the increased use of derivatives and the consequential accounting treatment thereof as well as the fair value accounting approach of the International Accounting Standards Board (IASB) have complicated the distinction between operating/trading and capital platform.

Short and simple: You adjust the earnings portion (Numerator) of basic earnings per share with all items/transactions that is non-operating/trading transactions. PS! The adjustment only need to take place if the items/transaction was not in, but should be, or was in and should not be in. Refer to schedule on p 152 (bl 155 Afr gids) and the table on page 153 – 158 (bl 156 - 160 Afr gids)

Example: Profit after tax for A Ltd is R 120 000. This includes a gain of R 20 000 on the disposal of an asset. A Ltd has 100 000 ordinary shares.

Basic earnings per shares = $120\,000/100\,000$ = R 12/share

Headline earnings per share = $(120\,000 - 20\,000)/100\,000$ = R 10/share

On page 155 of the study guide (bl 158 Afr gids) you will see that gains on PPE are included in profit for the year (therefore in basic earnings per share) but should be excluded in headline earnings per share.

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- **Headline earnings (continue)**

Example (illustrate headline earnings per share):

(Use the same information that was used in the example to illustrate basic earnings per share):

The profit before tax of A limited for the year ending 31 December 2011 equals to R 163 399. A Ltd has 25 000 ordinary shares and 1 000 10% cumulative preference shares (amounting to R 50 000) in issue on 1 January 2011. A Ltd issue a further 20 000 ordinary shares on 1 July 2011. Assume a SA normal tax rate of 28%. The non-controlling interest equals to 15%.

Additional information (The information below was included (only where applicable) in the profit before tax of R 163 399 as above) All transactions below took place during the 2011 financial year.

1. A Ltd holds an 80% interest in B Ltd.
2. A Ltd owns an investment property. During the year an valuator did a revaluation and concluded that the property value is R 32 000 higher than what was reported in 2010.
3. B Ltd performed a valuation on their factory machinery. They account for it on the revaluation method. The revaluation resulted in a R 12 000 increase in value, when compared to 2010 reported figures.
4. B Ltd impaired their computer equipment with R 20 000. The reason for this is lower productivity of the computers after it was attacked by a virus. The virus can not be removed.
5. The amortisation of intangible asset of A Ltd for the 2011 amounts to R 1 500.

Required: Calculate the basic- and headline earnings per share for the year end 31 December 2011

Earnings per share – IAS 33

Solution to the example:

Basic earnings per share = R 2.71 (95 000 / 35 000) (As per calculations earlier)

Headline earnings per share = R 2.39 (83 480 calc below) / 35 000)

	Notes	Gross R	Tax R	Non- controlling interest R
Basic earnings (as calculated earlier)		95 000		
Adjustments:				
Gain on revaluation of investment property (A Ltd)	1	(32 000)	8 960	
Gain on revaluation of machinery (property, plant and equipment (B Ltd)	2			
Impairment of computer equipment (property, plant and equipment (B Ltd)	3	20 000	(5 600)	(2 880)
Amortisation of Intangible assets (A Ltd)	4			
		83 000	3 360	(2 880)
Tax effect of adjustments		3 360		
Non controlling interest in adjustments		(2 880)		
Basic headline earnings		83 480		

Earnings per share – IAS 33

Explanatory notes:

1. This was originally included/taken into account in **profit for the year**, therefore in basic earnings (see p 158 of study guide, IAS 40 – bullet one in column 3) and should be out of headline earnings (column 6). So if it was included and it was a gain, and it should not be in, you need to deduct the amount. You should adjust the tax accordingly. Take note, if it was a loss, it was originally deducted and should then be added back.
2. This was originally included/taken into account in other comprehensive income, therefore **NOT** in basic earnings (see p 155 of study guide, IAS 16 – bullet four in column 3) and should be out of headline earnings (column 6). So if it was **NOT** included, and it should not be in, you do **NOT** need to change basic earnings with this amount.
3. This was originally included/taken into account in profit for the year, therefore in basic earnings (see p 155 of study guide, IAS 16 – bullet two in column 3) and should be out of headline earnings (column 6). So if it was included and it was an expense (deduction), and it should not be in, you need to add the amount back. You should adjust the tax accordingly. As this was a transaction of a company in the group that is not 100% owned, the non-controlling part should also be adjusted .
4. This was originally included/taken into account in profit for the year, therefore in basic earnings (see p 157 of study guide, IAS 38 – bullet one in column 3) and should be included in headline earnings (column 6). So if it was included/taken into account and it should be in, you do **NOT** need to change basic earnings with this amount.

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

- **Dividends per share**

Dividends per share is calculated by dividing dividends declared for the period by the number of issued shares on the date when the dividends were declared.

The calculation of dividends per share is therefore based on the number of **issued** shares and **not** on the weighted average number of issued shares. Comparative figures for dividends per share are only adjusted in the following instances:

- Capitalisation issues, bonus issues, a share split or a share consolidation
- Restatement of prior period figures due to a change in accounting policy or due to correction of a prior period error.

In the case where dividends are declared more than once during the period under review, a separate dividends per share must be calculated for each dividend payment. The sum of the separate dividends per share calculated can be disclosed in the statement of profit or loss and other comprehensive income or the dividends per share for each declaration can be disclosed.

An adjusted dividend per share must be calculated if the company issued capitalisation shares, bonus issues or a share split or share consolidation occurred in the current year. The result of these share transactions is that the number of shares increase or decrease but the R-value of issued share capital remains unchanged. The number of issued shares of the previous year is therefore adjusted and this requires an adjusted dividend per share calculation.

Earnings per share – IAS 33

Explanation of other rules, principles and scenarios that should be considered:

Disclosure:

- Basic and diluted earnings per share (refer to par 5.8 (P145 - 146 E guide, BI 147 - 148 A gids) in the study guide as well as IAS 33)
- Dividends per share (refer to par 5.9 (P147 E guide, BI 149 A gids) in the study guide as well as IAS 33)
- Headline earnings per share (refer to par 5.10.4 (P158 - 1159 E guide, BI 161 A gids) in the study guide as well as IAS 33)

RELATED PARTIES – IAS 24

Related party:

A person or an entity that is related to the reportable entity

1. Related Parties – Person / CC

- Control / joint control
- Significant influence
- Key management personnel etc.

2. Related Parties – Entity

- Members of the same group
- Associate / JV
- Post-employment benefit funds
- Controlled / Jointly controlled by person in #1
- Person in #1 has significant influence

RELATED PARTIES – IAS 24

Disclosure:

- Related Parties (Parties involved, nature of relationships, control etc.)
- Transactions & values during the year
- Outstanding balances at year end

Please refer to study unit 8 for detailed examples.

Examination preparation & technique

A few things to remember:

Before the examination

- a) All study units are important (see previous exams).
- b) Understand the basics of each study unit. (do not memorise)
- c) Know the disclosure requirements of each study unit. (this should be memorised)
- d) Make a one page summary per study unit, summarising what you understand. This should include your disclosure requirements.
- e) Work through previous exam question papers under exam conditions.
- f) Mark your paper (spent sufficient time). Identify your mistakes/shortcomings and refer back to study units and/or lecturers.
- g) Highlight mistakes on your paper and review regularly.
- h) Update summary per study unit throughout your studies.
- i) Read/review your summary on a regular basis.

Examination preparation & technique

A few things to remember:

During the examination

- a) Allocate time per question.
- b) Attempt **all** questions.
- c) Do the basics first, then the rest. (If you do not know the basics, try again next year!)
- d) When disclosure is required, write proper words as used in the study guide and accounting standards.
- e) Show calculations and reference properly.
- f) Do not duplicate calculations or disclosure.
- g) If you redo a calculation, first redo and then cancel your first calculation.
- h) Write until the end. That half mark can make a difference.
- i) When disclosure is required – Identify notes that should be disclosed, write the framework and all amounts given.
- j) Make sure about the information given, additional information given and what part of the additional information is included or not yet included in the information given, for example profit before tax etc.

Refer to tutorial letter 203 for a complete list.

Examination preparation & technique

Example - Complete vs Incomplete answering (and mark allocation) & Example of mark allocation when DISCLOSURE is asked.

PS! – THIS IS JUST AN EXAMPLE OF MARK ALLOCATION. IT WILL DIFFER FROM EXAM TO EXAM, DEPENDING ON CERTAIN FACTORS, FOR EXAMPLE COMPLEXITY OF QUESTIONS, ETC

Explanations of signs used in mark plan	
^	Half mark
✓	Full mark
1.5	One and a half mark is allocated to the calculation. This can be any figure (1.5 or 1 or 2 etc), depending on the complexity of the calculation.
^	Transfer mark

Take further note that you should be in class to understand the example in full context. There is also more than one method of good exam technique and disclosure. We will concentrate on only one of them.

Examination preparation & technique

COMPLETE ANSWER WHEN DISCLOSURE WAS REQUIRED (Notes to the AFS)

Marks		Calculations	R	Marks
	1. Profit before tax			
^	Included in profit before tax are the following items:			
	Other income – Government grants received		150	
^	In respect of the acquisition of machinery		100	^
^	In respect of salaries and wages	1	50	1
^	Depreciation		240	^ ^
	Net finance cost		175	
	Interest income		0	
^	Total interest received		300	^
^	Interest capitalised		300	^
	Interest expense		175	
^	Total interest expense	2	525	1.5
^	Interest capitalised	3	350	1.5

Examination preparation & technique

COMPLETE ANSWER WHEN DISCLOSURE WAS REQUIRED (Notes to the AFS)

Marks	2. Property, plant & Equipment			Marks		Marks
			Leased Assets	^	Owned Assets	^
^	Net carrying amount at the beginning of the year		360			
^	Cost	4	400	1		
^	Accumulated depreciation	5	(40)	1.5		
^	Acquisitions				750	^
^	Borrowing costs capitalised	6			50	1
^	Depreciation - owned assets	7			160	1.5
^	- Leased assets	8	80			1
	Net carrying amount at end of year		280		640	
	Cost		400		800	
	Accumulated depreciation		(120)		(160)	

Examination preparation & technique

Calculations:

COMPLETE ANSWER WHEN DISCLOSURE WAS REQUIRED (Notes to the AFS)	
1	$(100^{\wedge} / 2^{\wedge})$
2	$(7\ 000^{\wedge} \times 10\%^{\wedge} \times 9/12^{\wedge})$
3	$(7\ 000^{\wedge} \times 10\%^{\wedge} \times 6/12^{\wedge})$
4	$(385^{\wedge} + 15^{\wedge})$
5	$(400^{\wedge} \times 20\%^{\wedge} \times 6/12^{\wedge})$
6	$(350^{\wedge} - 300^{\wedge})$ (Transfer marks of amounts in note 1)
7	$[(700^{\wedge} + 50^{\wedge}) \times 20\%^{\wedge}]$
8	$(400^{\wedge} \times 20\%^{\wedge})$

Please take note that this is just an example, and also only a portion of what can be required to be disclosed. Ensure that all study units, as well as all prior examination papers as in tutorial letter 203, are studied thoroughly.

Examination preparation & technique

INCOMPLETE ANSWER WHEN DISCLOSURE WAS REQUIRED (Notes to the AFS)

Marks		Calculations	R	Marks
	1. Profit before tax			
	Other income – Government grants received		133	
	In respect of the acquisition of asset		100	^
	In respect of expenses		33	
^	Depreciation		259	^ ^
^	Interest received		300	^
^	Borrowing cost capitalised	1	350	1.5

Examination preparation & technique

INCOMPLETE ANSWER WHEN DISCLOSURE WAS REQUIRED (Notes to the AFS)

Marks	2. Property, plant & Equipment		Machinery	Marks	Equipment	Marks
	Net carrying amount		360			
^	Cost		385	^		
^	Accumulated depreciation		(25)			
^	Acquisitions				750	^
^	Borrowing costs capitalised				350	^
^	Depreciation - owned assets	2			220	1.5
^	- Leased assets	3	39			1
	Net carrying amount		321		640	
	Cost		385		800	
	Accumulated depreciation		(64)		(160)	

Examination preparation & technique

Calculations:

1	$(7\ 000 \wedge \times 10\% \wedge \times 6/12 \wedge)$
2	$[(750 \wedge + 350 \wedge) \times 20\% \wedge]$
3	$(385 \wedge \times 10\%)$

Examples of mistakes made in the Incomplete notes:

1. Descriptions were not comprehensive enough in note 1, for example it was not described exactly what the grant relates to, for example machinery, salaries and wages etc.
2. Calculations not shown or properly referenced in note 1, for example the grant i.t.o. salaries and wages. You could have calculated it as $100/3$, but did not show it. If it was shown, you would have received 1 of the 2 half marks as your “100” is correct.
3. Finance cost was not properly disclosed. Interest expense should be split between expense and capitalised portion, and income between received and capitalised.

Examination preparation & technique

Examples of mistakes made in the Incomplete notes: (continue)

4. No proper descriptions in note 2. Machinery etc are not correct, it should be owned- and leased assets. Net carrying amount? You should state when! Remember that you prepare financial statements in practice for outside users who do not have same knowledge as you on the company and on Accounting Standards.
5. Take note that in note 2, the depreciation on leased assets counts 1 mark. Due to the fact that the percentage used is not correct, but the calc was shown, you still get the one half mark for the cost as it is a transfer mark. If no calc was shown, you would not have received a mark.

This is just an example of a few common errors. It will be discussed in more detail during the discussion class. Please compare the two sets and see how easy marks were lost in the “incomplete” example.

Examination preparation & technique

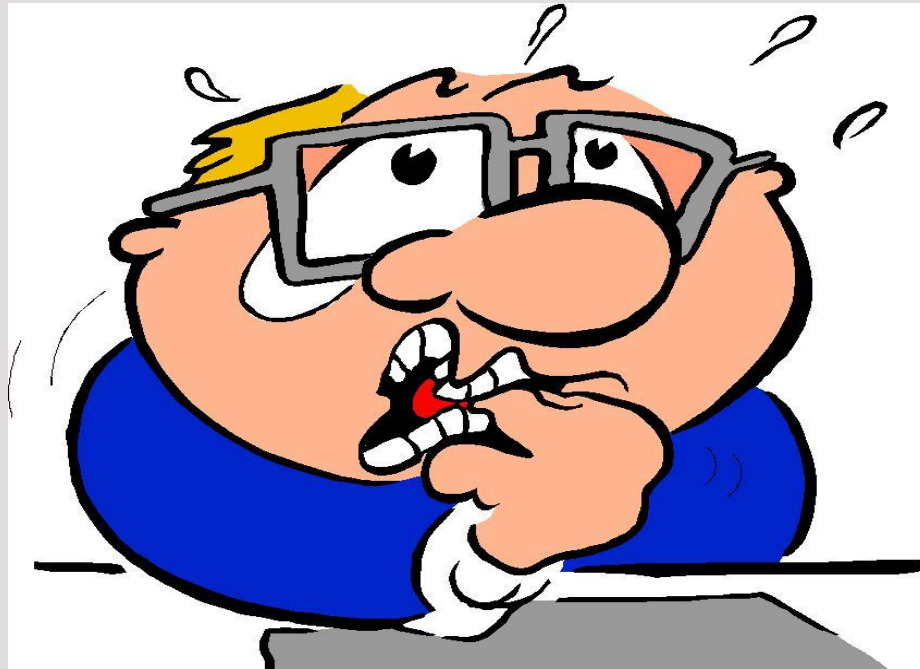
- Take note of the following that should be taken into account when disclosure or calculations are asked: (Just to name a few)

Disclosure

- What is required
- What is our financial period
- What is not required, for example Accounting policies etc, deferred tax note etc
- Descriptions of line items is very important
- Reference to calculations is very important, or add a extra column and show calc next to amount disclosed

Calculations

- What is required
- What is our financial period
- Signs of amounts – for example if depreciation for the current year is in brackets, bonus accrual for the current year should also be in brackets as both are expenses. Income should then not be in brackets. Leave accrual of the prior year that is reversed should then not be in brackets



QUESTIONS?



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Wishing you the best on your studies!