Tutorial letter 103/3/2017

General Financial Reporting

FAC3701

Semesters 1 & 2

Department of Financial Accounting

IMPORTANT INFORMATION:

This tutorial letter contains important information about your module.

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INTRODUCTION

Dear Student,

Attached please find additional integrated questions with their suggested solutions. We suggest that you do these questions under exam conditions. Once you have completed 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 indicate to you the standard required of you in the exam and will help you identify areas of weaknesses that you must pay attention to.

You will notice in our suggested solution, dealing with company financial statements, opposite certain items calculations are shown in brackets. Such calculations are given for tuition purposes only and consequently do not form part of the statutory disclosure requirements.

LECTURERS AND CONTACT DETAILS



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ADDITIONAL INTEGRATED QUESTIONS

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Please note: From 1 March 2016 the CGT inclusion rate for companies has been changed from 66,6% to 80%. This rate of 80% will be used for exam purposes in future.

The following abbreviations are used in this tutorial letter:

SFP ..... Statement of financial position

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

CA ..... Carrying amount

TB ..... Tax base

SP ..... Selling price

CP ..... Cost price



QUESTION 1 (54 marks)

LTea Ltd bottles and distributes ice tea. The financial manager of LTea Ltd, Mr G Nhamo, completed the draft financial statements for the year ended 30 September 20.10 on 15 November 20.10. On 30 November 20.10 the board of directors reviewed and authorised the financial statements for issue.

Included in the profit before tax of LTea Ltd for the year ended 30 September 20.10, amounting to R1 450 000, are the following items:

	20.10
Income	**R**
Annual agency fees (refer 4)	600 000
Profit on sale of machine (refer 1)	80 000
Expenses	
Depreciation - administration building (refer 2)	90 000
Depreciation – machinery (refer 1)	74 000
Depreciation - furniture and fittings (refer 2)	150 000

Additional information:

1. On 31 December 20.09 the directors of LTea Ltd decided to replace an old machine used for the bottling of ice tea with a new machine. On 31 December 20.09 the old machine was sold for R290 000. The old machine was acquired on 1 October 20.08 at a cost of R280 000. On the date of sale the carrying amount and tax base of the old machine amounted to R210 000 and R192 500 respectively. On 2 January 20.10 a new machine was acquired for R400 000 and immediately brought into use. The carrying amount and tax base of the newly acquired machine on 30 September 20.10 amounted to R340 000 and R325 000 respectively. Depreciation on machinery is written off at 20% per annum according to the straight-line method. The tax allowance on machinery is written off over 4 years (pro-rata) according to the straight-line method. The tax allowance on machinery for the year ended 30 September 20.10 amounted to R92 500. No other machinery were acquired or sold during the year.

2. On 1 August 20.09, LTea Ltd signed a contract with Lester Ltd to repair all the office furniture in their eight storey administration building. The contract stipulated the contract price to be R200 000, payable on completion of the contract. Lester Ltd estimated that the total cost to repair all the furniture in the administration building of LTea Ltd would amount to R120 000. At 30 September 20.09, Lester Ltd completed 25% of the repairs of the furniture (based on the costs incurred to date to total expected costs). On 30 June 20.10 Lester Ltd completed the remainder of the contract. After inspection of the repair work done, LTea Ltd issued a cheque on 2 July 20.10 for the work completed. The repair expense has been recorded in the accounting records of LTea Ltd according to the requirements of *International Financial Reporting Standards (IFRSs)*. The SA Revenue Service will allow the repair costs as a deduction when these costs are actually paid. Depreciation on the administration building is written off at 2% per annum according to the straight-line method. The SA Revenue Service does not allow any capital allowances on the administration building. Furniture and fittings are depreciated at 20% per annum according to the straight-line method which is consistent with the capital allowance on furniture and fittings allowed by the SA Revenue Service.

3. As a result of the increase in the demand for ice tea, the current warehouse used by LTea Ltd to store the ice tea has become too small. On 30 September 20.10 the directors decided to relocate to a bigger warehouse in a nearby town. Upon cancellation of the operating lease agreement of the current warehouse, which only expires on 30 September 20.11, a penalty of 60% of the outstanding amounts will be payable. The rental of the warehouse currently amount to R3 500 per month, payable in arrears. The lease payments for the year ended 30 September 20.10 have been paid up to date. The lease contract stipulates that LTea Ltd cannot sublet the warehouse.

QUESTION 1 (continued)

4. LTea Ltd use independent distribution agents to distribute their ice tea throughout Africa. LTea Ltd has developed customary business practices to analyse customer's changing preferences and to implement product improvements, pricing strategies and marketing campaigns to support the franchise name. These agents need to sign a contract and pay a special agency fee of R90 000 for the exclusive right to distribute the ice tea in a specific area. These agency fees are payable in advance in three equal annual instalments over the contract period. The first instalment of R30 000 is payable on the commencement date of the contract. The annual agency fees included in profit before tax of LTea Ltd for the year ended 30 September 20.10 consist of the following:

	R
First instalments received relating to contracts commencing on 1 October 20.09	240 000
Second instalments received relating to contracts commencing on 1 October 20.08	360 000
	600 000

The first instalment of agency fees in respect of contracts which only commences on 1 October 20.10, amounting to R180 000, was also received in advance in the current year.

5. LTea Ltd increases their inventory levels of ice tea closer to September in order to provide for the increased demand for ice tea during the summer months. After the draft financial statements for the year ended 30 September 20.10 had been prepared, the directors decided to change the inventory valuation method of the ice tea in order to comply with *International Financial Reporting Standards (IFRSs)*. The valuation method was changed from the last-in-first-out method to the first-in-first-out method. The change in the inventory valuation method has not been accounted for yet in the accounting records of LTea Ltd for the year ended 30 September 20.10.

The value of inventory based on the different valuation methods was as follows:

	Last-in, First-out	**First-in, First-out**	**Difference**
	R	**R**	**R**
30 September 20.08	190 000	230 000	40 000
30 September 20.09	296 000	344 000	48 000
30 September 20.10	305 000	355 000	50 000

The SA Revenue Service indicated that they will accept the new inventory valuation method for tax purposes and that they will **not** reopen the previous year's tax assessments.

6. The company provides for deferred tax on all temporary differences according to the statement of financial position approach. There is certainty beyond any reasonable doubt, that the company will have sufficient taxable profit in future against which any deductible temporary differences can be utilised. There are no other exempt or temporary differences except those mentioned in the question.

7. The SA Normal tax rate has remained unchanged at 28% for the past few years. All capital gains are taxable at 80%.

8. The tax assessment of LTea Ltd for the year ended 30 September 20.09, which was received on 31 January 20.10, showed that the company had an assessed loss of R130 000, which was in agreement with the accounting records of the company.

9. LTea Ltd made the following provisional tax payments for the financial year ended 30 September 20.10:

	R
31 March 20.10	110 000
30 September 20.10	70 000
	180 000

10. Assume that all amounts are material.

QUESTION 1 (continued)



REQUIRED:

a) Prepare the relevant journal entries for additional information (2) above to recognise **revenue** in the accounting records of Lester Ltd for **both** the financial years ended 30 September 20.09 and 30 September 20.10 according to the requirements of *IFRS 15 – Revenue from contracts with customers*.

The accounting policy of Lester Ltd states that revenue is recognised based on an input method for performance obligations satisfied over time. The input method is determined based on costs incurred relative to total expected costs.

Journal narrations are **not** required. Ignore the implications of tax. (5½)

b) Motivate, with reasons, why the repairs to the office furniture in the administration building in additional information (2) above should be recognised as an expense in the statement of profit and loss and other comprehensive income of LTea Ltd for the year ended 30 September 20.10, according to the requirements of an **expense** in terms of the *Conceptual Framework for Financial Reporting 2010*. (5)

c) Calculate the current tax due by LTea Ltd to the SA Revenue Service for the year ended 30 September 20.10. (14½)

d) Calculate the deferred tax balance in the statement of financial position of LTea Ltd **using the statement of financial position approach** for **both** the years ended 30 September 20.09 and 30 September 20.10. Indicate if the balance is a deferred tax asset or deferred tax liability. (10½)

e) Disclose the tax rate reconciliation, using **R-values only**, in the annual financial statements of LTea Ltd for the year ended 30 September 20.10, according to the requirements of *IAS 12 – Income taxes*.

All calculations must be shown. Comparative figures are **not** required. (4)

f) Disclose **only** additional information (5) above in the notes to the annual financial statements of LTea Ltd for the year ended 30 September 20.10 according to the requirements of *IAS 8 – Accounting policies, changes in accounting estimates and errors.*

Comparative figures **are required.**
No other notes are required.
No accounting policy notes are required. (14½)



QUESTION 2 (46 marks)

Stoneridge Ltd is a manufacturer and retailer of car polish and tyres. The annual financial statements of Stoneridge Ltd for the year ended 28 February 2011 were presented to the board of directors for authorisation for issue on 30 April 2011.

The profit before tax of Stoneridge Ltd, **before** taking into account the additional information below, for the years ended 28 February 2011 and 28 February 2010 amounted to R980 000 and R890 000 respectively.

QUESTION 2 (continued)

The SA Normal tax rate has remained unchanged at 28% for the past three years.

The company provides for deferred tax on all temporary differences according to the statement of financial position approach. There is certainty beyond any reasonable doubt, that the company will have sufficient taxable profit in future against which any deductible temporary differences can be utilised. There are no other exempt or temporary differences except those mentioned in the question.

Assume that all amounts are material.

Additional information:

1. The accounts receivable balance in the draft statement of financial position of Stoneridge Ltd comprised of the following debtors:

	28 February 2011 R	28 February 2010 R
Dash Ltd	80 000	90 000
Save Security Ltd	120 000	120 000
Glow Ltd	110 000	-
Glasstop Ltd	60 000	-
	370 000	210 000

   When the auditors performed the current year's debtors circulation it was discovered that no monies were owed by Save Security Ltd (refer above). Stoneridge Ltd made a payment of R120 000 on 1 November 2009 for security services rendered for the period from 1 November 2009 to 31 October 2010. This payment was then incorrectly allocated to the accounts receivable account. The effect of this is considered to be material. The SA Revenue Service indicated that they will re-open the previous year's tax assessments.

   On 1 November 2010 Stoneridge Ltd cancelled the security services arrangement with Save Security Ltd and instituted a claim of R50 000 against Save Security Ltd for failing to protect the premises and warehouse of Stoneridge Ltd (refer 3). The court case is scheduled for 5 April 2011. According to the legal advisors of Stoneridge Ltd there is sufficient evidence against Save Security Ltd to prove that they were negligent when they rendered their services and it is probable that Stoneridge Ltd will be successful with their claim.

2. Stoneridge Ltd sells its tyres with a six month warranty against all material defects, excluding normal wear and tear. The six month warranty cannot be purchased separately. The tyres returned will then either be repaired or replaced free of charge to the customer. The provision for warranty costs for the current year, which has already been recorded in the accounting records of Stoneridge Ltd, amounted to R100 000 and is based on the following assumptions:
   - 80% of the tyres sold will have no defects,
   - 15% of the tyres sold will have minor defects, and
   - 5% of the tyres sold will have major defects.

   However, the recent quality control surveys conducted by Stoneridge Ltd during the financial year ended 28 February 2011 showed that the tyres sold are actually returned as follows:
   - 90% of the tyres sold will have no defects,
   - 6% of the tyres sold will have minor defects, and
   - 4% of the tyres sold will have major defects.

   Subsequently the directors decided at a recent board meeting that the warranty provision does not give an appropriate presentation of the actual warranty costs incurred and that it should rather be based on the results of the recent quality control surveys. According to recent quality control surveys, if minor defects are detected in all tyres sold, repair costs will amount to R400 000 and if major defects are detected in all tyres sold, repair costs will amount to R800 000.

QUESTION 2 (continued)

Actual warranty costs paid in respect of tyres sold with a material defect for the year ended 28 February 2011 amounted to R90 000 (2010 – R70 000). Actual warranty costs and reversals for warranty costs are debited against the provision for warranty costs and have already been recorded in the accounting records of Stoneridge Ltd. The balance of the provision for warranty costs for the years ended 28 February 2010 and 28 February 2009 amounted to R120 000 and R80 000 respectively.

3. After recent unrest amongst employees at the premises of Stoneridge Ltd three employees of Stoneridge Ltd were dismissed. Subsequently, the trade union to which these employees belonged instituted a claim of R55 000 against Stoneridge Ltd for the unfair dismissal of these employees. At year end on 28 February 2011 the lawyers of Stoneridge Ltd indicated that the claim against them will probably not succeed. The recent unrest at the premises of Stoneridge Ltd also resulted in extensive damage to Stoneridge Ltd's warehouse as well as the neighbouring company, Glasstop Ltd's warehouse. Unfortunately Glasstop Ltd was not insured and the damage to their warehouse led to the company filing for insolvency on 10 April 2011. Glasstop Ltd was also a debtor of Stoneridge Ltd and R60 000 relating to Glasstop Ltd (also refer to 1 above) is included in the accounts receivable balance in the statement of financial position of Stoneridge Ltd on 28 February 2011. The liquidators of Glasstop Ltd announced on 20 April 2011 that 0,20 cents in the R1 will be paid on liquidation. On 1 April 2011 Stoneridge Ltd concluded a contract, amounting to R100 000, with Max Contractors Ltd to repair the damage to Stoneridge Ltd's warehouse.

4. The following transactions for the current financial year with National Tyres Ltd, a new customer of Stoneridge Ltd, have not been accounted for yet in the accounting records of Stoneridge Ltd:

- Tyres with a cost price of R20 000 were sold to National Tyres Ltd in a consignment arrangement. These tyres are sold at a gross profit of 20% on sales price. At year end on 28 February 2011 National Tyres Ltd had not sold 60% of these tyres supplied to them.
- On 1 June 2010 Stoneridge Ltd acquired tyre tubes from National Tyres Ltd in exchange for a wheel alignment machine. The fair value of the tyre tubes and wheel alignment machine amounted to R80 000 and R82 000 respectively. The selling price and cost price of the wheel alignment machine amounted to R90 000 and R70 000 respectively.
- On 24 February 2011, Stoneridge Ltd sold polish drums with a cost price of R16 000 for R22 000 on a cash on delivery basis to National Tyres Ltd. At year end on 28 February 2011 payment for the full order was received. However, on 28 February 2011 only 70% of the polish drums had actually been delivered to the premises of National Tyres Ltd due to transport problems. Stoneridge Ltd transfers control of the polish drums on delivery to National Tyres Ltd.



REQUIRED:

a) Prepare the necessary **correcting** journal entry for additional information (2) above in the accounting records of Stoneridge Ltd for the year ended 28 February 2011.

Journal narrations are **not** required.
All calculations must be done to the nearest Rand.
Ignore the effects of taxation. (3½)

b) Calculate the profit before tax of Stoneridge Ltd for both the years ended 28 February 2011 and 28 February 2010, taking into account all the additional information above. (11½)

c) Calculate the **deferred tax balance** of Stoneridge Ltd for the year ended 28 February 2011, **using the statement of financial position approach**. Indicate if the balance is a deferred tax asset or liability. (4)

QUESTION 2 (continued)

	d) Disclose additional information (1), (2) and (3) above in the notes to the annual financial statements of Stoneridge Ltd for the year ended 28 February 2011, according to the requirements of *IAS 8 – Accounting policies, changes in accounting estimates and errors, IAS 10 – Events after the reporting period and IAS 37 – Provisions, contingent liabilities and contingents assets.* Comparative figures **are required.** **No** other notes are required. **No** accounting policy notes are required. (27)



QUESTION 3 (38 marks)

The following information relates to Rainbow Ltd, a manufacturer and retailer of paints, for the year ended 28 February 20.11:

1. The profit before tax of Rainbow Ltd for the year ended 28 February 20.11 amounted to R690 000, according to the draft financial statements compiled by an inexperienced accounting clerk. The revenue of Rainbow Ltd for the year ended 28 February 20.11 consisted of the following: royalties received amounting to R485 000 (20.10: R220 000), cash on delivery sales amounting to R350 000 (20.10: R50 000) and credit sales amounting to R250 000 (20.10: R40 000).

   - Included in cash on delivery sales above is an amount of R40 000 received on 2 February 20.11 from Glow Ltd in respect of an order for paints which was only despatched to Glow Ltd on 10 March 20.11. Rainbow Ltd transfers control of the order of paints once delivery of the paints is made to Glow Ltd.
   - Included in credit sales above is an amount of R10 000 owing by Stone Ltd to Rainbow Ltd. However on 10 April 20.11 Stone Ltd indicated that they are unable to pay the money's due as they were placed under liquidation and its creditors will probably only receive 10 cent in the rand as a liquidation dividend.

   Included in other income of Rainbow Ltd for the year ended 28 February 20.11 are dividends received from an unlisted investment amounting to R60 000 (20.10: R20 000) and an amount of R12 000 in respect of a profit realised on the sale of Machine Max. Machine Max was originally purchased on 1 March 20.08 at a cost of R20 000 and sold on 1 March 20.10 for R24 000. The carrying amount and tax base of Machine Max on date of sale amounted to R12 000 and R10 000 respectively.

2. Rainbow Ltd purchased all its machinery on 1 March 20.08 at a cost of R500 000 (excluding Machine Max) on which date it was estimated that the machinery will have a useful life of 5 years and a Rnil residual value. After the draft financial statements have been prepared, the directors of Rainbow Ltd re-estimated the remaining useful life of machinery and determined that their remaining useful life is actually only 2 years as they are already used to their full capacity. The residual value of the machinery remained unchanged at Rnil. On 28 February 20.10 the carrying amount and the tax base of the machinery (excluding Machine Max) amounted to R300 000 and R250 000 respectively. This change in the useful life of machinery has not been recorded yet in the draft financial statements of Rainbow Ltd for the year ended 28 February 20.11. The SA Revenue Service allows a capital allowance on machinery over 4 years according to the straight-line method. No other machinery were purchased or sold during the year except for Machine Max.

QUESTION 3 (continued)

3. Included in current liabilities in the statement of financial position of Rainbow Ltd at 28 February 20.11 is an amount of R20 000 in respect of royalties received for the period from 1 March 20.11 to 30 June 20.11 for the patent rights of "Quick Dry" paint manufactured by Rainbow Ltd.

4. The inexperienced accounting clerk made the following entries for the current year in the "current tax due to the SA Revenue Service" account in the general ledger of Rainbow Ltd:

Dr	**SA Revenue Service – current tax**						**Cr**
31/8/20.10	Bank (1st provisional tax payment for 20.11)		50 000	01/3/20.10	Balance (relating to 20.10 tax year)	b/d	20 000
30/9/20.10	Bank (final payment of assessment for 20.10, **including** R4 000 interest and R6 000 penalties for the late submission of tax return)		15 000	28/2/20.11	Balance	c/d	115 000
28/2/20.11	Bank (2nd provisional tax payment for 20.11)		70 000				
			135 000				135 000
01/3/20.11	Balance	b/d	115 000				

No provision for current tax has been made yet in the draft financial statements for the year ended 28 February 20.11.

5. The SA Normal tax rate changed from 29% in 20.10 to 28% in 20.11. 80% of all capital gains are taxable. The company provides for deferred tax on all temporary differences according to the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. There is certainty beyond any reasonable doubt, that the company will have sufficient taxable profit in the future against which any deductible temporary differences can be utilised. The deferred tax liability balance on 28 February 20.10 amounted to R15 080, **which you can assume to be correct**.

6. The financial statements of Rainbow Ltd for the year ended 28 February 20.11 were presented to the board of directors for authorisation for issue on 20 April 20.11.

7. Ignore any VAT implications.

8. Assume all amounts to be material.



REQUIRED:

a) Calculate the correct profit before tax in the statement of profit or loss and other comprehensive income of Rainbow Ltd for the year ended 28 February 20.11 taking into account all the above mentioned information. (5)

b) Calculate the current tax due to the SA Revenue Service by Rainbow Ltd for the year ended 28 February 20.11. Use the profit before tax in the statement of profit or loss and other comprehensive income as calculated in **(a)** above as your starting point. (10)

QUESTION 3 (continued)

	c) Calculate the deferred tax balance in the statement of financial position of Rainbow Ltd for the year ended 28 February 20.11 **using the statement of financial position approach**, according to the requirements of *IAS 12 – Income taxes*. Indicate if your answer is a deferred tax asset or deferred tax liability. (6) d) Disclose the tax rate reconciliation, using **R-values only**, in the annual financial statements of Rainbow Ltd for the year ended 28 February 20.11, according to the requirements of *IAS 12 – Income taxes*. All calculations must be shown. Comparative figures are **not required.** (11) e) Disclose (2) in the notes to the annual financial statements of Rainbow Ltd for the year ended 28 February 20.11, according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors*. Comparative figures **are required**. **No** other notes are required. **No** accounting policy notes are required. (6)



QUESTION 4 (54 marks)

Bemington Ltd is a manufacturer and retailer of cosmetic products and appliances. Their products are sold at their own retail outlet in Isipingo, Durban as well as to various chain stores. The annual financial statements of Bemington Ltd for the year ended 28 February 2011 were presented to the board of directors for authorisation for issue on 25 April 2011.

The company provides for deferred tax on all temporary differences according to the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. There is certainty beyond reasonable doubt that there will be sufficient taxable profit in future against which any deductible temporary differences can be utilised.

The SA Normal tax rate has remained unchanged at 28% for the past three years.

Ignore any VAT implications.

Assume all amounts to be material.

Additional information

1. Bemington Ltd has a policy to refund purchases of electric shavers sold within 2 months from the date of sale to dissatisfied customers. This refund policy is generally known and advertised in the insert packages of the electric shavers sold. A provision for refunds amounting to R25 000 was made in the annual financial statements of Bemington Ltd for the year ended 28 February 2010 (2009: Rnil), based on the past sales and refund history of these electric shavers. During the current financial year R30 000 was paid to dissatisfied customers for electric shavers sold of which R9 000 related to sales of electric shavers for the year ended 28 February 2010. The financial director estimated, based on the sales for the year and the refund history, that R40 000 will most probably be refunded to dissatisfied customers in the first two months of the next financial year for electric

QUESTION 4 (continued)

shavers sold during the year ended 28 February 2011. The manufacturer of the electric shavers also provides a guarantee to Bemington Ltd for any manufacturing defects on these electric shavers. At year end on 28 February 2011 it is probable, but not virtually certain, that 60% of these estimated costs will be refunded by the manufacturer of these electric shavers to Bemington Ltd.

2. During February 2011 Blue Cross Ltd, an animal activist group, instituted a claim of R100 000 against Bemington Ltd. The group claims that Bemington Ltd tested cosmetic products on animals, resulting in animals being injured in the process. At year end on 28 February 2011, the legal advisor of Bemington Ltd is of the opinion that it is probable that Bemington Ltd will not be found liable for the claim.

3. Bemington Ltd valued all its inventory according to the weighted average method. After the draft financial statements for the year ended 28 February 2011 had been prepared, the directors decided at a board meeting that the current inventory valuation method should be changed to the first-in, first-out method in order to improve the matching of revenue and expenses. Unfortunately the inventory valuations according to the first-in, first-out method for all the years prior to 2011 could not be determined due to a malfunction in the computer program which is used for the costing of inventory.

   The inventory valuation according to the different methods on 28 February 2011 is as follows:

	Raw Materials	**Work in progress**	**Finished goods**	**Total**
	R	**R**	**R**	**R**
First-in, first out method	88 000	120 000	370 000	578 000
Weighted average method	78 000	108 000	340 000	526 000

   The SA Revenue Service has indicated that they will accept the new inventory valuation method for tax purposes.

   During the current year's audit it was discovered that finished goods inventory located at the Isipingo retail outlet, was inadvertently excluded in the abovementioned inventory valuations since the 2009 financial year. The value of finished goods inventory located at the Isipingo retail outlet on the respective dates was as follows:

	Weighted average	**First-in, first-out**
	R	**R**
28 February 2009	115 000	?
28 February 2010	20 000	?
28 February 2011	110 000	120 000

   The SA Revenue Service has already indicated that they will re-open all the previous years' tax assessments as both the change in the inventory valuation method and the exclusion of finished goods located at the Isipingo retail outlet are considered material.

   During the first week of April 2011 a water pipe burst in the Isipingo retail outlet resulting in damage to finished goods with a cost price of R60 000. The company was not insured for these damages at the time.

QUESTION 4 (continued)

4. Mr Wiseman, an inexperienced accountant recently employed by Bemington Ltd, recorded the following journal entries in the accounting records of Bemington Ltd for the year ended 28 February 2011:

Journal no	Description	Debit R	Credit R
(i)	Accounts receivable (SFP) #	800 000	
	Revenue (P/L)*		800 000
	Recording of generic products supplied to various chain stores.		
(ii)	Bank (SFP) #	50 000	
	Revenue (P/L)*		50 000
	Recording of gift vouchers sold in exchange for merchandise at discounted prices.		

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

During a review of the journal entries and subsequent discussions with the inexperienced accountant, Mr Wiseman, it was confirmed that the above journal entries were the **only** entries made in the accounting records of Bemington Ltd for the year ended 28 February 2011 in respect of the information detailed below:

(i) During January 2011, Bemington Ltd started to manufacture generic cosmetic products. These generic cosmetic products are sold in a consignment arrangement. Generic cosmetic products with a sales price of R800 000 were supplied in a consignment arrangement in January 2011 to the various chain stores at a gross profit of 25% on cost price. At year end on 28 February 2011, the various chain stores had only sold 40% of the consignment inventory supplied to them during the current year by Bemington Ltd, but no money's have been received from the chain stores in respect of these consignment sales yet.

(ii) During the current year the Isipingo retail outlet in Durban sold gift vouchers amounting to R50 000, in exchange for the issue of cosmetic products to the bearer at a discount of 25% on selling price, in an attempt to increase the turnover of the company. At year end on 28 February 2011, no cosmetic products have been issued at discounted prices yet as no gift vouchers have been redeemed.



REQUIRED:

a) Motivate with reasons, why a provision for refunds in additional information (1) should be raised in the accounting records of Bemington Ltd for the year ended 28 February 2011 according to the requirements of a **liability** in terms of the *Conceptual Framework for Financial Reporting 2010*. (5)

b) Disclose additional information (1) and (2) above in the notes to the annual financial statements of Bemington Ltd for the year ended 28 February 2011, according to the requirements of **only** *IAS 37 – Provisions, contingent liabilities and contingent assets.*

No accounting policy notes are required.
Comparative figures **are required**. (14)

c) Disclose additional information (3) above in the notes to the annual financial statements of Bemington Ltd for the year ended 28 February 2011, according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors and IAS 10 – Events after the reporting period.*

No accounting policy notes are required.
Comparative figures **are required**. (24½)

QUESTION 4 (continued)

	d) Prepare the **additional** and **correcting journals** in the books of Bemington Ltd taking into account all the additional information in (4) above**,** for the year ended 28 February 2011. Use the journal number provided in the question as your point of reference. Indicate if it is a statement of financial position (SFP) or statement of profit or loss and other comprehensive income (P/L) general ledger account in your journal. Journal narrations are **not** required. Ignore all tax implications. (7) e) Calculate the deferred tax balance in the statement of financial position of Bemington Ltd for the year ended 28 February 2011 **using the statement of financial position approach**. Indicate if your answer is a deferred tax asset or deferred tax liability in the statement of financial position. (3½)



QUESTION 5 (52 marks)

PastryCook Ltd is a manufacturer of biscuit machines which are sold to various retail stores throughout South Africa. PastryCook Ltd also owns various bakeries selling a range of biscuits and pastries baked at their premises. The profit before tax of PastryCook Ltd in the draft financial statements for the year ended 31 December 2011 amounted to R1 250 000, **before** taking into account any adjustments as a result of the additional information below.

Additional information

1. During the last quarter of the current financial year PastryCook Ltd launched the following two new sales initiatives:

1.1 On 1 October 2011 a customer loyalty programme was launched awarding the participating customers with one loyalty credit for every R50 spent on the purchase of biscuits. The management of PastryCook Ltd estimate the stand-alone selling price of each loyalty credit to be R1,20. The loyalty credits earned during the first three months of the programme will only be redeemable from 1 January 2012 in exchange for discounted items. The biscuits that are sold in terms of the loyalty programme are sold at a gross profit of 25% on cost price. Biscuits are usually sold at a gross profit of 24% on cost price, which you can assume to be the stand-alone selling price of the biscuits.

Only the following journals have been recorded in the accounting records of PastryCook Ltd for the year ended 31 December 2011, relating to the sales of biscuits for the period 1 October 2011 to 31 December 2011:

	Debit R	**Credit R**
Bank	225 000	
Revenue		225 000
Cost of sales	180 000	
Inventory		180 000

1.2 In November 2011 PastryCook Ltd signed a contract with Cakes Ltd to sell biscuit machines on behalf of PastryCook Ltd in a consignment arrangement from 1 December 2011. Biscuit machines are sold to customers at a gross profit percentage of 30% on cost. At year end on 31 December 2011 only 80% of the biscuit machines had been sold to customers and all the unsold biscuit machines returned to PastryCook Ltd.

QUESTION 5 (continued)

Only the following journal entry has been recorded in the accounting records of PastryCook Ltd for the year ended 31 December 2011, relating to the consignment stock supplied to Cakes Ltd at cost:

	Debit R	Credit R
Consignment inventory	70 000	
Inventory		70 000

2. On 30 April 2011, a new more advanced biscuit baking oven was acquired and installed at PastryCook Ltd's premises in order to reduce the baking time of the biscuits and increase capacity. It was immediately put into use on this date. Subsequently, on 1 July 2011, the old baking oven, originally acquired on 1 January 2009 was sold resulting in an accounting loss of R50 000. The details of the new and old baking ovens are as follows:

	New baking oven R	Old baking oven R
Cost	240 000	120 000
Carrying amount – 31 December 2010	N/A	72 000
Carrying amount – 30 April 2011	240 000	64 000
Carrying amount – 1 July 2011	232 000	60 000
Carrying amount – 31 December 2011	208 000	N/A
Tax base – 31 December 2010	N/A	60 000

The depreciation on both of the baking ovens as well as the accounting loss on the sale of the old baking oven have already been recorded in the draft financial statements of PastryCook Ltd for the year ended 31 December 2011. The tax allowance on baking ovens is 4 years (pro-rata) according to the straight-line method.

3. After the draft financial statements for the year ended 31 December 2011 had been prepared, the directors decided to change the inventory valuation method as this will result in a fair presentation of the financial position and operating results of the company because of fluctuations in inventory prices. The valuation method was changed from the weighted average method to the first-in, first-out method. The change in the inventory valuation method has **not** been accounted for yet in the accounting records of PastryCook Ltd for the year ended 31 December 2011.

The value of inventory based on the different valuation methods was as follows:

	Weighted Average R	First-in, First-out R	Difference R
31 December 2009	380 000	389 000	9 000
31 December 2010	420 000	445 000	25 000
31 December 2011	470 000	508 000	38 000

The SA Revenue Service indicated that they will accept the new inventory valuation method for tax purposes, but they will **not** reopen the previous years' tax assessments.

4. On 1 November 2010 PastryCook Ltd discovered a material manufacturing defect in a specific range of biscuit machines manufactured. The company decided to repair all the defective biscuit machines already sold to customers free of charge. At the time management estimated that costs of R110 000 would have to be incurred to repair these defective biscuit machines already sold and subsequently raised a provision for these costs on 1 November 2010. On 1 December 2010 and 31 March 2011, costs of R28 000 and R102 000 respectively were paid cash to repair these defective biscuit machines manufactured. At 31 December 2011 it is expected that no further costs to repair these defective biscuit machines manufactured will have to be incurred in the next financial year.

QUESTION 5 (continued)

Only the following entries have been made by the inexperienced accounting clerk in the "provision for manufacturing defects" account in the general ledger of PastryCook Ltd:

Dr			Provision for manufacturing defects				Cr
01/12/2010	Bank		28 000	01/11/2010	Claims (P/L)		110 000
31/03/2011	Bank		102 000	31/12/2011	Balance	c/d	20 000
			130 000				130 000
01/01/2012	Balance	b/d	20 000				

5. During the current financial year, PastryCook Ltd made the following payments to the SA Revenue Service in respect of the 2011 tax year:

	R
30 August 2011 (1st provisional tax payment)	120 000
30 August 2011 (fines for late submission of 1st provisional tax payment)	5 500
31 December 2011 (2nd provisional tax payment)	110 000
	235 500

6. The financial manager agreed with the tax assessment of PastryCook Ltd for the year ended 31 December 2010, which showed an underprovision of R8 000 for the 2010 tax year due to an incorrect tax calculation by PastryCook Ltd.

7. The profit before tax of PastryCook Ltd for the year ended 31 December 2011 includes foreign income of R50 000, which is not taxable in South Africa in terms of a double taxation agreement. The company paid foreign taxes of R6 500 on this income.

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

9. The SA Normal tax rate is 28%.

10. Assume that all amounts are material.



REQUIRED:

a) Prepare the correcting journal entry for additional information **(1.1)** above in the accounting records of PastryCook Ltd for the year ended 31 December 2011 according to the requirements of *IFRS 15 – Revenue from contracts with customers.*

Journal narrations are **not** required.
No abbreviations for the general ledger account names in your journal must be used.
Ignore the implications of tax. (2½)

b) Calculate the correct profit before tax in the statement of profit or loss and other comprehensive income of PastryCook Ltd for the year ended 31 December 2011 taking into account all the additional information above. (4½)

c) Calculate the current tax due by PastryCook Ltd to the SA Revenue Service for the year ended 31 December 2011. Use the profit before tax calculated in **(b)** above as your starting point. (13½)

QUESTION 5 (continued)

d) Calculate the deferred tax balance in the statement of financial position of PastryCook Ltd **using the statement of financial position approach for both** the years ended 31 December 2010 and 31 December 2011. Indicate if the balance is a deferred tax asset or liability in the statement of financial position of PastryCook Ltd. (6)

e) Disclose the tax rate reconciliation, using **R-values only**, in the annual financial statements of PastryCook Ltd for the year ended 31 December 2011, according to the requirements of *IAS 12 – Income taxes*.

All calculations must be shown.
Comparative figures are **not** required. (5½)

f) Disclose additional information **(3)** and **(4)** above in the notes to the annual financial statements of PastryCook Ltd for the year ended 31 December 2011 according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors* and *IAS 37 – Provisions, contingent liabilities and contingent assets*.

Comparative figures **are required**.
No other notes are required.
No accounting policy notes are required. (20)



QUESTION 6 (48 marks)

THIS QUESTION CONSISTS OF 2 INDEPENDENT PARTS

PART A

MallWart Ltd is an international retail company specializing in the sale of numerous consumer goods. Their aim is to maximize profit through increased sales volumes at low profit margins. MallWart Ltd entered the South African retail market four years ago after a takeover of SmallCart Ltd, a company operating various retail stores across South Africa.

The SA Normal tax rate is 28%.

Assume all amounts to be material.

Additional information

1. Customers in the retail stores of MallWart Ltd sign a 36 month 3G internet contract with an independent company NCC Cellular to purchase a 1Gig internet bundle. The contracts also have an option for the customer to purchase a Bell Laptop, with a retail value of R10 000 each, for an additional R350 per month over the 36 month contract period. MallWart Ltd supplies the laptop to the customer and is subsequently fully reimbursed by NCC Cellular for the retail value on inception date of the contract. NCC Cellular provides all the warranties and technical assistance to customers. The cost price of the Bell Laptops amount to R8 000 each. NCC Cellular pays MallWart Ltd commission amounting to R500 per contract. During the current financial year customers signed 110 3G contracts in the retail stores of MallWart Ltd of which 60 included a laptop.

QUESTION 6 (continued)

During the audit finding meeting the financial manager of MallWart Ltd indicated that the commission earned on the 3G contracts as well as the sale of the laptops, subject to the 3G contracts, have **not** been recorded yet in the accounting records of MallWart Ltd as he was unsure about the accounting treatment thereof. At year end on 29 February 2012 both the commission as well as the reimbursement of the laptops are still outstanding and due by NCC Cellular.

2. On 1 March 2010 MallWart Ltd purchased and installed wage clock machines at their retail stores as a result of irregular claims made by employees for overtime hours worked. During the current financial year's audit it was discovered that MallWart Ltd incorrectly debited the costs of the wage clock machines amounting to R850 000 to the wages account in the previous financial year. MallWart Ltd depreciates the wage clock machines over 5 years according to the straight-line method. The SA Revenue Service allows a tax allowance over 3 years on wage clock machines according to the straight-line method.

   The tax effect of the above misallocation is considered to be material and the SA Revenue Service indicated that they will reopen the tax assessment for the prior year.

3. MallWart Ltd recognize a provision for expected warranty costs to be incurred relating to all electronic products sold during the past 3 years with a 3 year warranty against any manufacturing defects. This policy is well advertised in the product brochures distributed by MallWart Ltd. You may assume that the warranty cannot be purchased separately and does not provide the customer with a service in addition to the assurance. During the current financial year, the directors of MallWart Ltd decided to change the policy for warranty provisions. This decision was based on the continuous improved quality of MallWart Ltd's products, which resulted in a significant decrease in warranty claims from clients of MallWart Ltd. The new policy will give a more realistic valuation of expected future warranty costs.

   The warranty provision already provided and accounted for in the draft financial statements for the year ended 29 February 2012 was calculated as follows:
   The sum of:
   - 4% of sales in the current financial year; and
   - 3% of sales that took place in the previous financial year; and
   - 2% of sales in the year preceding the previous financial year.

   In future the warranty provision will be based on the assumption that only 5% of sales of electronic products in the current financial year will be returned in the future due to manufacturing defects. This change in the basis of the calculation of the warranty provision has not been accounted for yet in the draft financial statements for the current year. The total sales value of electronic products sold with a 3 year warranty were as follows:

	R
29 February 2012	4 600 000
28 February 2011	3 300 000
28 February 2010	2 500 000

4. On 31 January 2012 the Labour Union representing MallWart Ltd's employees instituted a claim of R400 000 against MallWart Ltd for not adhering to the original terms as agreed upon during the takeover of SmallCart Ltd. MallWart Ltd decreased their employee numbers by 15% during the current financial year which is 5% more than agreed upon at the time of the takeover of SmallCart Ltd. At 29 February 2012 the legal advisors of MallWart Ltd are of the opinion that it is not probable that the Labour Union will be successful with their claim against MallWart Ltd.

QUESTION 6 (continued)

5. On 10 February 2012 MallWart Ltd instituted a claim of R740 000 against FlamFlung Ltd. The claim relates to defective 3D High Definition LED televisions which were sold to MallWart Ltd during the current financial year. MallWart Ltd was obliged to recall all FlamFlung Ltd televisions sold to customers during the current year and to refund the full purchase price to the customers. The court case is scheduled for 19 March 2012. According to the legal advisors of MallWart Ltd there is sufficient evidence against FlamFlung Ltd to prove that they were aware at the time that their products were defective and therefore it is probable but not virtually certain that MallWart Ltd will be successful with their claim.



REQUIRED:

a) Motivate with reasons if the laptops given to clients with the sale of the 3G contracts in additional information **(1)** above can be recognized by MallWart Ltd as revenue for the year ended 29 February 2012 according to the requirements of *IFRS 15 – Revenue from contracts with customers.*

Calculations need not form part of your answer. (6)

b) Prepare all the necessary journal entries for additional information **(1) to (5)** above in the accounting records of MallWart Ltd only for the year ended 29 February 2012.

Journal narrations are **not** required.
No abbreviations for general ledger account names in your journal must be used.
Ignore the implications of tax (16½)

c) Motivate with reasons what the correct accounting treatment for the wage clock machines in additional information **(2)** should be according to the requirements of an asset in terms of the *Conceptual Framework for Financial Reporting 2010*. (6)

d) Disclose additional information **(2), (4) and (5)** above in the notes to the annual financial statements of MallWart Ltd for the year ended 29 February 2012, according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors* and *IAS 37 – Provisions, contingent liabilities and contingent assets.*

Comparative figures **are** required.
No other notes are required.
No accounting policy notes are required. (13½)

PART B

The following information relating to Prague Ltd, a company with a 31 March year end, was obtained after a review of the minutes of Prague Ltd:

- On 4 April 2011 the board of directors of Prague Ltd declared an ordinary dividend of R650 000 for the year ended 31 March 2011, subject to the approval of the annual general meeting. At the annual general meeting held on 15 May 2011, the proposed ordinary dividends were approved.
- The annual financial statements of Prague Ltd for the year ended 31 March 2011 were authorized for issue on 15 May 2011.
- On 15 April 2012 the board of directors of Prague Ltd declared a preference dividend of 10 cents per share for the year ended 31 March 2012. There are 100 000 preference shares in issue.

QUESTION 6 (continued)

- The annual financial statements of Prague Ltd for the year ended 31 March 2012 were authorized for issue on 5 May 2012.

The following is an extract from the statement of profit or loss and other comprehensive income of Prague Ltd for the year ended 31 March 2012:

PRAGUE LTD
EXTRACT FROM STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 MARCH 2012

	R
Gross profit	1 867 500
Other income	130 000
Administration expenses	(225 000)
Profit before tax	1 772 500
Income tax expense	(458 000)
Profit for the year	1 314 500
Other comprehensive income:	
Items that will not be reclassified to profit or loss:	
Gains on property revaluation	32 500
Actuarial gains on defined benefit pension plans	25 000
Other comprehensive income for the year, net of tax	57 500
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	1 372 000

The retained earnings of Prague Ltd on 1 April 2011 amounted to R1 490 000.



REQUIRED:

Using the information presented above prepare only:

- the retained earnings section of the statement of changes in equity as well as
- the relevant dividend note to the annual financial statements

of Prague Ltd for the year ended 31 March 2012. Your answer must comply with the requirements of **only** *IAS 1 – Presentation of financial statements* and *IAS 10 – Events after the reporting period.*

No comparative figures are required.
Accounting policy notes are **not** required.
No other notes are required. (6)



QUESTION 7 (52 marks)

4Feed Ltd is a well diversified company that manufactures and sells a range of animal food products to various supermarkets, pet stores and veterinary clinics. The annual financial statements of 4Feed Ltd for the year ended 30 June 2012, were presented to the board of directors for authorisation for issue on 15 August 2012.

QUESTION 7 (continued)

The following are extracts from the draft financial statements of 4Feed Ltd for the year ended 30 June 2012, **before** taking into account the additional information below:

4FEED LTD
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2012

	2012 R	2011 R
Profit before tax (refer 1)	940 000	870 000

4FEED LTD
STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2012

	2012 R	2011 R
Manufacturing equipment – carrying amount (refer 2)	360 000	360 000
Inventory (refer 3)	900 000	210 000

Additional information

1. Profit before tax includes the following:

	2012 R	2011 R
Income		
Revenue (refer 1.1)	1 100 000	900 500
Foreign income received from Zimbabwe (refer 1.2)	240 000	215 000
Expenses		
Depreciation – manufacturing equipment (refer 2)	?	80 000
Repairs to water pipes (refer 3)	17 000	-
Donations – Animal Rights National Conference (not tax deductible) (refer 5)	110 000	-

1.1 Revenue includes an amount of R60 000 received on 1 June 2012 from a new pet shop that recently opened, for an order of various animal food products. Due to a backlog of orders, the animal food products were only delivered to the new pet shop on 10 July 2012. 4Feed Ltd sells all its animal food products at a gross profit percentage of 20% on cost price. 4Feed Ltd transfers control of the animal food products on delivery to the new petshop.

1.2 Foreign income received from cattle food sold to the Ministry of Agriculture in Zimbabwe, as part of the livestock feeding programme, is not taxable in South Africa in terms of a double taxation agreement. 4Feed Ltd paid foreign taxes of R36 000 on this income.

2. During the current financial year's audit, the auditors discovered that repair costs incurred on 30 June 2011, to repair the manufacturing equipment damaged whilst moving it, were incorrectly recorded in the general ledger. It was allocated to the manufacturing equipment account instead of the repair expense account. The total amount of R40 000 debited to the manufacturing equipment general ledger account consisted of the following:

	R
Repair costs	35 088
VAT at 14%	4 912
	40 000

Manufacturing equipment is depreciated according to the reducing balance method at 20% per annum. During June 2012 the directors decided to change this method to the straight-line method and estimated that the remaining useful life of the manufacturing equipment is 4 years. The residual

QUESTION 7 (continued)

value of the manufacturing equipment remained unchanged at Rnil. The SA Revenue Service allows a capital allowance over 5 years on the manufacturing equipment according to the straight-line method.

At incorporation of the company on 1 July 2009 all manufacturing equipment were acquired at a cost of R500 000 and immediately put into use. The tax base of the manufacturing equipment on 30 June 2011 amounted to R340 000. No depreciation charge for the current year has been recorded yet in the accounting records of 4Feed Ltd. No other manufacturing equipment were acquired or sold since incorporation of the company.

The SA Revenue Service indicated that they will reopen the previous year's tax assessment and will issue a revised tax assessment in respect of the 2011 tax year. The SA Revenue Service also agreed to refund the VAT input of R4 912 not claimed by 4Feed Ltd in the previous year.

3. During the first week of July 2012, it was discovered that cat food inventory with a cost of R210 500 was mouldy and could therefore not be sold to customers. This inventory became mouldy as a result of water leakage caused by burst water pipes in the leased inventory warehouse during June 2012. This inventory of R210 500 was included as inventory in the statement of financial position of 4Feed Ltd at year end on 30 June 2012.

   In June 2012 4Feed Ltd paid R17 000 for the repair of these water pipes in the warehouse. Due to the damage caused by the burst water pipes it is probable, but not virtually certain, that the landlord of the warehouse will refund 4Feed Ltd for the repair costs incurred.

4. The balance of the allowance for credit losses in the statement of financial position of 4Feed Ltd on the respective dates was as follows:

	R
30 June 2011	40 000
30 June 2012	31 000

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

5. On 31 January 2012 4Feed Ltd donated R110 000 to the Animal Rights National Conference which was held in May 2012 in Bloemfontein and recorded it in the accounting records of 4Feed Ltd as donations paid.

6. On 15 January 2012 4Feed Ltd received a claim of R500 000 from the Benfontein Horse Racing Club after one of its champion race horses died during a horse race. The horse racing club alleges that the horse died as a result of the horse feed it ate which was produced by 4Feed Ltd. Initial tests found traces of toxic substances in the specific batch of horse feed. At year end on 30 June 2012 the lawyers of 4Feed Ltd are of the opinion that it is not probable that 4Feed Ltd will be found liable for the claim.

   A claim of R100 000 was also received on 20 January 2012 from Mr Kansvat, a frequent horse racing gambler. He alleges that his gambling earnings were ltd as a result of the death of the above mentioned race horse. At year end on 30 June 2012 the legal advisors of 4Feed Ltd are of the opinion that the probability of the claim received from Mr Kansvat of being successful is remote.

7. The SA Normal tax rate remained unchanged at 28%. The company provides for deferred tax on all temporary differences according to the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. There is certainty beyond any reasonable doubt, that the company will have sufficient taxable profit in the future against which any deductible temporary differences can be utilised.

QUESTION 7 (continued)

8. 4Feed Ltd made the following provisional tax payments for the financial year ended 30 June 2012:

	R
31 December 2011	65 000
30 June 2012	55 000

9. Ignore all VAT implications, except for the additional information provided in (2). 4Feed Ltd is a registered VAT vendor.

10. Assume all amounts to be material.



REQUIRED:

a) The financial director of 4Feed Ltd is of the opinion that the R110 000 donation made to the Animal Rights National Conference (refer additional information (5)) should be capitalised and then amortised over 3 years. The name of 4Feed Ltd will be promoted as it appears on all the billboards at the Animal Rights National Conference and it is expected that the public image of 4Feed Ltd will benefit from this for a period of at least 3 years.

Discuss, with reasons, if the donation of R110 000 should be capitalised as an **asset** by 4Feed Ltd according to the requirements of an **asset** in terms of the *Conceptual Framework for Financial Reporting 2010*. (6)

b) Prepare all the necessary correcting journals as per additional information **(1.1)** to record the transactions in the accounting records of 4Feed Ltd for the year ended 30 June 2012. Clearly indicate in your answer if it is a statement of financial position (SFP) or a statement of profit or loss and other comprehensive income (P/L) general ledger account.

Do **not** use abbreviations for general ledger account names in your journals.
Journal narrations are **not** required.
Ignore the tax implications. (3½)

c) Calculate the correct profit before tax in the statement of profit or loss and other comprehensive income of 4Feed Ltd for the year ended 30 June 2012, taking into account all the above mentioned information. (3½)

d) Calculate the current tax due to the SA Revenue Service by 4Feed Ltd for the year ended 30 June 2012. Use the profit before tax in the statement of profit or loss and other comprehensive income as calculated in (c) above as your starting point. (8½)

e) Calculate the deferred tax balance in the statement of financial position of 4Feed Ltd at 30 June 2012 **using the statement of financial position approach**, according to the requirements of *IAS 12 – Income taxes*. Indicate if your answer is a deferred tax asset or deferred tax liability in the statement of financial position. (6)

f) Disclose the tax rate reconciliation, **using R-values only,** in the annual financial statements of 4Feed Ltd for the year ended 30 June 2012, according to the requirements of *IAS 12 – Income taxes*.

All calculations must be shown.
No comparative figures are required. (5)

QUESTION 7 (continued)

	g) Disclose additional information **(2)**, **(3)** and **(6)** in the notes to the annual financial statements of 4Feed Ltd for the year ended 30 June 2012, according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors* and *IAS 37 – Provisions, contingent liabilities and contingent assets.* If relevant, clearly state in your answer the reason for not disclosing any of the additional information in **(2)**, **(3)** and **(6)** in the notes to the annual financial statements of 4Feed Ltd for the year ended 30 June 2012. All calculations must be shown. **No** other notes are required. **No** accounting policy notes are required. (19½)



QUESTION 8 (43 marks)

THIS QUESTION CONSISTS OF TWO (2) INDEPENDENT PARTS

PART A (39 marks)

Datacaps Ltd is an Information Technology (IT) service provider that specialises in the implementation of mega databases, the capturing and processing of data as well as the development of specialised software which is used by clients for the capturing of data. These services are primarily rendered to credit bureaus, universities, banks, post graduate research students and government departments. The annual financial statements of Datacaps Ltd for the year ended 29 February 2012 were presented to the board of directors for authorisation for issue on 30 April 2012.

The company provides for deferred tax on all temporary differences according to the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. There is certainty beyond reasonable doubt that there will be sufficient taxable profit in future against which any deductible temporary differences can be utilised.

The SA Normal tax rate has remained unchanged at 28% for the past three years.

Ignore any VAT implications.

Assume all amounts to be material.

Additional information

1. On 31 October 2010 Datacaps Ltd's computer data warehouse was completely destroyed by a fire caused by arson during a riot. In the process NLS Bank's financial data, a client of Datacaps Ltd, was also completely destroyed in the fire. The database administrator of Datacaps Ltd assured NLS Bank that Datacaps Ltd will recover the financial data of NLS Bank at no cost to NLS Bank. Subsequently Datacaps Ltd employed a data recovery specialist to recover the destroyed financial data of NLS Bank. At the time it was estimated that the cost to recover the financial data would amount to R685 000. Therefore on 30 November 2010 a provision for the recovery of the financial data of NLS Bank was made in the accounting records of Datacaps Ltd.

QUESTION 8 (continued)

Datacaps Ltd made the following payments on the respective dates to the data recovery specialist for the recovery of the financial data of NLS Bank:

	R
31 December 2010	230 000
31 January 2011	127 000
31 March 2011	305 000

The data recovery specialist successfully completed the recovery process of the financial data of NLS Bank on 31 March 2011 and it is expected that no further costs will be incurred.

On 1 March 2011 Datacaps Ltd paid a third party R400 000 to store off-site backups of all data held by Datacaps Ltd. These backups of data will be updated annually at a cost to limit the risk of data loss in future.

The inexperienced accounting clerk of Datacaps Ltd has recorded only the following journal entry on 30 November 2010 in the accounting records of Datacaps Ltd relating to the abovementioned:

	Debit R	Credit R
Data recovery costs (P/L)	685 000	
Provision for data recovery costs (SFP)		685 000
Being provision made for data recovery costs of data destroyed of NLS Bank.		

2. After the review of the draft financial statements of Datacaps Ltd, the financial director decided to change the current inventory valuation method from the weighted average method to the first-in, first-out method in order to improve the matching of revenue and expenses to ensure a more fair presentation of the financial position of the company. This change in accounting policy has not yet been recorded in the accounting records of Datacaps Ltd.

   The financial director indicated that the value of inventory according to the first-in, first-out method on 28 February 2010 could not be determined as some of Datacaps Ltd's own data was also destroyed in the fire (refer 1). The following is a summary of the closing inventory of Datacaps Ltd on the respective dates:

	29 February 2012 R	28 February 2011 R	28 February 2010 R
According to the first-in, first-out method	450 000	195 000	?
According to the weighted average method	330 000	175 000	315 000
	120 000	20 000	?

   The SA Revenue Service indicated that they will accept the new inventory valuation method for tax purposes but will **not** re-open the previous years' tax assessments.

3. On 2 January 2012 Datacaps Ltd paid Microloft Ltd R60 000 in respect of licence fees for the right of access to Microloft Ltd's database software for a period of 2 years.

   The inexperienced accounting clerk has recorded only the following journal entry on 29 February 2012 in the accounting records of Datacaps Ltd for the amount paid to Microloft Ltd:

	Debit R	Credit R
Licence fees paid (P/L)	60 000	
Bank (SFP)		60 000
Being license fees paid for the use of Microloft Ltd's database software		

QUESTION 8 (continued)

4. During February 2012 Datacaps Ltd provided data capturing services amounting to R50 000 (excluding discount) to TMD Ltd on credit. Datacaps Ltd has a policy of granting an early settlement discount of 2% to customers, if customer accounts are settled within six months. At year end on 29 February 2012 Datacaps Ltd expected TMD Ltd to settle their account at the end of April 2012.

   The inexperienced accounting clerk has recorded only the following journal entry on 29 February 2012 in the accounting records of Datacaps Ltd for the data capturing services rendered to TMD Ltd:

	Debit R	Credit R
Accounts receivable (SFP)	50 000	
Service fees received (P/L)		50 000
Being data capturing services rendered on credit to TMD Ltd		

5. On 31 March 2012 ASBA Ltd, a major financial investment group, announced that it has downgraded all credit ratings for companies in the IT industry. The announcement by ASBA Ltd resulted in a significant decline in the share price of Datacaps Ltd on the Securities Exchange from R2,00 per share to 50 cents per share. It is furthermore expected that Datacaps Ltd will experience a significant decline in profits in future due to the negative market sentiment towards the IT industry after the announcement.



REQUIRED:

a) Prepare the additional and correcting journal entries in the books of Datacaps Ltd taking into account all additional information in **(1), (3)** and **(4)** above for **both** the years ended 28 February 2011 and 29 February 2012. Clearly indicate in your answer if it is a statement of financial position (SFP) or a statement of profit or loss and other comprehensive income (P/L) general ledger account.

   Do **not** use abbreviations for general ledger account names in your journals.
   Journal narrations are **not** required.
   Ignore any tax implications.
   All calculations are to be done to the nearest Rand. (12½)

b) Disclose additional information **(1)**, **(2)**, and **(5)** in the notes to the annual financial statements of Datacaps Ltd for the year ended 29 February 2012 according to the requirements of **only** *IAS 8 - Accounting policies, changes in accounting estimates and errors, IAS 37 – Provisions, contingent liabilities and contingent assets* and *IAS 10 – Events after the reporting period.*

   No accounting policy notes are required.
   Comparative figures **are required.** (22)

c) Calculate the deferred tax balance in the statement of financial position of Datacaps Ltd for **both** the years ended 29 February 2012 and 28 February 2011 **using the statement of financial position approach**, according to the requirements of *IAS 12 – Income taxes*. Indicate if your answer is a deferred tax asset or deferred tax liability in the statement of financial position. (4½)

QUESTION 8 (continued)

PART B (4 marks)

In terms of *IFRS 13 – Fair value measurement*, market participants are buyers and sellers in the principal market (or most advantageous market) for an asset or liability. *IFRS 13 – Fair value measurement*, identifies the characteristics of these market participants.



REQUIRED:

Describe the characteristics of these market participants according to the requirements of *IFRS 13 – Fair value measurement*. (4)



QUESTION 9 (50 marks)

Eprint Ltd manufactures and sells electronic books (digital books) and also operates a printing press for the printing of books and pamphlets for its customers.

You have recently been appointed as the financial accountant of Eprint Ltd after the immigration of the previous financial accountant to Australia. You have been asked to update the accounting records with all the transactions not recorded to date and to finalise the draft annual financial statements of Eprint Ltd for the year ended 31 March 20.13. The annual financial statements of Eprint Ltd for the year ended 31 March 20.13 will be presented to the board of directors for authorisation for issue on 5 May 20.13.

The profit before tax according to the draft financial statements of Eprint Ltd for the financial year ended 31 March 20.13 amounted to R1 144 000.

You are presented with the following information of Eprint Ltd when finalising the annual financial statements for the year ended 31 March 20.13:

1. The following is an extract of the draft tax rate reconciliation prepared by the previous financial accountant, which you can assume to be **correct**:

	R
Tax at standard rate	320 320
Reconciling items:	
Penalty (refer 1.1)	2 240
Foreign income (refer 1.2)	(9 600)
Capital profit on sale of machine (refer 2)	(4 204)
Income tax expense	308 756

1.1 This penalty is due to the late submission of the second provisional tax return for the financial year ended 31 March 20.13. The first and second provisional tax payments made by Eprint Ltd for the financial year ended 31 March 20.13 amounted to R28 000 and R22 000 respectively.

1.2 Foreign income received from Zimbabwe, is not taxable in the Republic of South Africa in terms of a double taxation agreement. Eprint Ltd paid foreign taxes of R24 000 on this income.

2. The directors of the company decided to sell and replace their existing printing machine, the Gobbler Machine, with the Eco Green Machine. This new printing machine will decrease the printing costs by 25% as it uses less ink and electricity and prints at twice the speed of the Gobbler Machine.

QUESTION 9 (continued)

Details of the respective machines are as follows:

	Gobbler Machine	Eco Green Machine
Cost price	R420 000	R584 000
Date of purchase	1 January 20.12	1 December 20.12
Date of sale	1 January 20.13	N/A
Selling price	R495 075	N/A
Profit on sale	R159 075	N/A
Depreciation for the year ended 31 March 20.12	R21 000	N/A
Depreciation for the year ended 31 March 20.13	R63 000	R29 200
Tax allowance (straight line)– not pro-rata	4 years	4 years

All the relevant transactions relating to the above printing machines have already been recorded in the accounting records of Eprint Ltd for the year ended 31 March 20.13.

3. During February 20.12 the directors of Eprint Ltd decided to implement a guarantee policy to repair all electronic books with a manufacturing defect at no cost to the customer, within 6 months from date of sale. You may assume that the guarantee policy cannot be purchased separately and does not provide the customer with a service in addition to the assurance. No costs in respect of this guarantee policy were incurred during the financial year ended 31 March 20.12. The following journal entries relating to this provision were recorded by the previous accountant in the accounting records of Eprint Ltd, which you can assume to be **correct**:

	Debit R	Credit R
31 March 20.12		
3.1 Repair costs (P/L)	36 000	
Provision for manufacturing defects (SFP)		36 000
Provision raised for possible repair costs to be incurred in terms of the guarantee policy in respect of electronic books sold during the year ended 31 March 20.12		
31 March 20.13		
3.2 Provision for manufacturing defects (SFP)	29 500	
Bank (SFP)		29 500
Repair costs paid in respect of the guarantee policy for electronic books sold during the year ended 31 March 20.12		
3.3 Provision for manufacturing defects (SFP)	6 500	
Repair costs (P/L)		6 500
Reversal of unused provision raised for repair costs in respect of electronic books sold during the year ended 31 March 20.12		
3.4 Repair costs (P/L)	43 500	
Provision for manufacturing defects (SFP)		43 500
Provision raised for possible repair costs to be incurred in terms of the guarantee policy in respect of electronic books sold during the year ended 31 March 20.13		

4. The directors of Eprint Ltd decided to change the accounting policy in respect of the valuation of inventory, as the new policy will ensure a more reliable value of inventory. Inventories were previously valued according to the weighted average method, but it should now be valued according to the first-in, first-out (FIFO) method. The new method of inventory valuation **has already been correctly accounted for** in the accounting records of Eprint Ltd for the year ended 31 March 20.13.

QUESTION 9 (continued)

The effect of the change in inventory valuation is as follows:

Inventory	20.11 R	Difference R	20.12 R	Difference R	20.13 R
FIFO	95 000		103 000		230 000
Weighted average	(112 000)		(145 000)		(290 000)
Decrease in profit	(17 000)	(25 000)	(42 000)	(18 000)	(60 000)
Tax effect	4 760	7 000	11 760	5 040	16 800
	(12 240)	(18 000)	(30 240)	(12 960)	(43 200)

The SA Revenue Service indicated that they will **not** accept the new inventory valuation method for tax purposes and they will **not** reopen the previous years' tax assessments.

5. On 15 April 20.13, on the return flight after attending a meeting in Cape Town, you incidentally overheard a conversation between the chief executive officer and the chief financial officer of KidsBooks Ltd, a significant customer of Eprint Ltd. KidsBooks Ltd was currently experiencing serious financial and cashflow problems after their national warehouse was destroyed by a fire on 9 April 20.13. This warehouse of KidsBooks Ltd was not insured for fire caused by lightning. There is uncertainty if KidsBooks Ltd will be able to settle their outstanding debt, due to Eprint Ltd amounting to R130 130, on 31 March 20.13.

The SA Normal tax rate remained unchanged at 28% for the past 3 years. All capital gains are taxable at 80%.

The company provides for deferred tax on all temporary differences using the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. There is certainty beyond any reasonable doubt that there will be sufficient taxable profit in the future against which any deductible temporary differences can be utilised. The deferred tax liability balance on 31 March 20.12, after taking into account the change in inventory valuation, amounted to R1 680.

The retained earnings of Eprint Ltd at 31 March 20.11 amounted to R1 827 760 and the profit after tax for the year ended 31 March 20.12 amounted to R650 000.

Assume all amounts to be material.



REQUIRED:

a) With reference to journal **3.1** in information (3) above, identify the relevant elements of financial statements. For each of these elements identified, also state the definition of the relevant elements identified. Your answer must comply with the requirements of the *Conceptual Framework for Financial Reporting 2010*. (5½)

b) Disclose the income tax expense note, **excluding the tax rate reconciliation**, to the annual financial statements of Eprint Ltd for the year ended 31 March 20.13, according to the requirements of *IAS 12 – Income taxes.* The deferred tax expense for the year ended 31 March 20.13 should be calculated **using the statement of financial position approach,** according to the requirements of *IAS 12 – Income taxes*

No comparative figures are required.
All calculations are to be done to the nearest Rand. (24)

QUESTION 9 (continued)

	c) Disclose information **(3)** and **(5)** above in the notes to the annual financial statements of Eprint Ltd for the year ended 31 March 20.13, according to the requirements of **only** *IAS 37 – Provisions, contingent liabilities and contingent assets* and *IAS 10 – Events after the reporting period.* **No** other notes are required. **No** accounting policy notes are required. (10½) d) Prepare **only** the retained earnings section of the statement of changes in equity of Eprint Ltd for the year ended 31 March 20.13, taking into account the new inventory valuation method. Your answer must comply with the requirements of *International Financial Reporting Standards (IFRSs)*. Comparative figures are required. **No** notes are required. The statement of profit or loss and other comprehensive income is **not** required. (7½) e) Disclose inventory in the statement of financial position of Eprint Ltd at 31 March 20.13. Your answer must comply with the requirements of *International Financial Reporting Standards (IFRSs)*. Comparative figures are required. (2½)



QUESTION 10 (50 marks)

THIS QUESTION CONSISTS OF 2 INDEPENDENT PARTS

PART A (43 marks)

Carnastie Ltd is a South African company which operates and owns the Carnastie golf resort as well as a golf equipment manufacturing plant, specializing in the manufacturing of the Bling golf club brand. The resort has an 18 hole championship golf course, Carnastie Links.

The profit before tax of Carnastie Ltd in the draft financial statements for the year ended 28 February 2013 amounted to R1 550 000, **before** taking into account any adjustments as a result of the additional information below.

The SA Normal tax rate is 28%.

Deferred tax is provided for on all temporary differences according to the statement of financial position approach. The company will have sufficient taxable profit in future against which any unused tax losses can be utilized. There are no other items causing temporary differences except those mentioned in the question.

Assume all amounts are material.

QUESTION 10 (continued)

Additional information

1. Only Carnastie golf club members can use the facilities of the Carnastie Links golf course. An annual membership fee payable on the 1st of March each year entitles members to use all the facilities at the golf course.

   During the current financial year the accountant, Mr. Big Easy, requested you to assist him with the accounting of the following revenue transactions of Carnastie Links golf course, which have **not** been included in the draft financial statements for the year ended 28 February 2013 yet:

   - For the current financial year 34 membership application forms were received from prospective members but only 14 new members were accepted by the club. At 1 March 2012 all the annual membership fees were fully paid up by the new and existing members. No outstanding membership fees were due from prior years.
   - Annual membership fees for the 85 members in the previous financial year amounted to R5 700 per member. All of these members also remained members for the current financial year. The annual membership fees annually increase with 10%.
   - On 1 March 2012 Carnastie Links golf course instituted a membership loyalty programme. Members pay R513 per game of golf, which is also regarded as the stand-alone selling price thereof. Members are rewarded with one free game of golf for every ten golf games played. A total of 12 free golf games were rewarded during the 2013 financial year in terms of the loyalty programme. All free golf games rewarded in terms of the loyalty programme can only be redeemed during the 2014 financial year. It is expected that all free golf games awarded through the loyalty programme will be exercised. A total of 1 330 golf games were actually played during the 2013 financial year.

2. Carnastie Ltd manufactures and sells golf equipment under the Bling brand to leading golf retailers and golf pro shops. During the current financial year's audit it was discovered that the inexperienced accounting clerk, Mr. Goose, incorrectly debited four credit notes (detailed below) to the trade payables account. The credit notes were correctly credited to the trade receivables account. The adjustment to the cost of sales account in respect of these credit notes was correctly recorded in the accounting records of Carnastie Ltd.

   Details of the four credit notes are as follows:

Date	**Credit note number**	**Debtor**	**Amount R**
15 February 2012	1662	Duffer Ltd	190 000
28 February 2012	1663	Slice Ltd	260 000
15 March 2012	1664	Drive Ltd	48 500
10 April 2012	1665	Acker Ltd	80 000

   The tax effect of the above misallocations is considered to be material and the SA Revenue Service indicated that they will reopen the tax assessment for the prior year. No adjustments for the above incorrect allocations have been recorded yet in the accounting records of Carnastie Ltd.

3. On 1 March 2010 Carnastie Ltd purchased a Dear John tractor at a cost of R2 500 000 for course maintenance at the Carnastie Links golf course. The Dear John tractor is depreciated on the reducing balance method at 25% per annum. However, after a review of the draft financial statements for the year ended 28 February 2013 the directors decided to change this method to the straight-line method. The expected useful life at the date of purchase of the Dear John tractor was estimated as 5 years with a residual value of Rnil. The depreciation charge on the tractor for the current year, calculated according to the reducing balance method, has already been recorded in the accounting records of Carnastie Ltd.

QUESTION 10 (continued)

The carrying amount of the Dear John tractor on the respective dates was as follows:

	R
28 February 2013	1 054 688
29 February 2012	1 406 250
28 February 2011	1 875 000

The tax allowance on tractors is 5 years according to the straight-line method.

4. On 30 January 2013 Carnastie Ltd sold adjustable drivers to a new customer, Caddyshack Ltd, at a gross profit of 25% on cost price and received the full payment of R400 000 in cash. Caddyshack Ltd is currently in the process of opening its golf "megaworld" shop in Gauteng. Caddyshack Ltd immediately "took title and accepted billing" for the adjustable drivers sold, but requested to postpone delivery until 10 March 2013 due to their shop still being refurbished. Carnastie Ltd stored these adjustable drivers separately in their warehouse ready for delivery and per agreement cannot sell the adjustable drivers to another customer. This transaction has not been recorded yet in the accounting records of Carnastie Ltd for the year ended 28 February 2013.

5. On 12 February 2013 Green Peace instituted a claim of R3 500 000 against Carnastie Ltd for environmental damage caused to a wetland adjacent to the Carnastie Links golf course. According to Green Peace the damage was caused by fertilizer used by Carnastie Links on their greens, polluting the environmentally sensitive wetland. At 28 February 2013 the legal advisor of Carnastie Ltd was of the opinion that it is not probable that Green Peace will be successful with their claim against Carnastie Ltd.

6. On 31 January 2013 Carnastie Ltd instituted a claim of R340 000 against Fallaway Golf. The claim relates to a patent infringement by Fallaway Golf for the illegal copying of the Bling brand's technology. The court case is scheduled for 31 March 2013. According to the legal advisor of Carnastie Ltd there is sufficient evidence against Fallaway Golf to prove that they infringed on the Bling brand's patent and therefore it is probable but not virtually certain that Carnastie Ltd will be successful with their claim.



REQUIRED:

a) The accountant of Carnastie Ltd wants to recognise the bill and hold arrangement to Caddyshack Ltd (additional information 4) as revenue for the current year, but is uncertain of the requirements for the recognition of a bill and hold arrangement as revenue. State the additional requirements that must be met for the recognition of the bill and hold arrangement as revenue for the current year, according to the requirements of the *Appendix B to IFRS 15 – Revenue from contracts with customers*.

Calculations need not form part of your answer. (4)

b) Prepare all the necessary journal entries for additional information **(1) to (6)** above in the accounting records of Carnastie Ltd for all the transactions that occurred during the current year ended 28 February 2013.

Journal narrations are **not** required.
All calculations are to be done to the nearest Rand.
No abbreviations for general ledger account names in your journal must be used.
Indicate in your journal if it is a statement of financial position (SFP) or statement of profit or loss and other comprehensive income (P/L) general ledger account.
Ignore the implications of tax and VAT. (17)

QUESTION 10 (continued)

c) Calculate the deferred tax balance of Carnastie Ltd for the year ended 28 February 2013 using the **statement of financial position approach**, according to the requirements of *IAS 12 – Income taxes*. Indicate if the balance is a deferred tax asset or liability. (5)

d) Disclose additional information **(2), (3), (5) and (6)** above in the notes to the annual financial statements of Carnastie Ltd for the year ended 28 February 2013, according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors* and *IAS 37 – Provisions, contingent liabilities and contingent assets*.

Ignore the implications of VAT.
Comparative figures **are** required.
No other notes are required.
No accounting policy notes are required. (17)

PART B (7 marks)

Glasgow Ltd acquired a manufacturing plant at a cost of R1 500 000 on 1 March 2012. Glasgow Ltd wants to measure the plant at fair value, according to the requirements of *IFRS 13 – Fair value measurement*, for the financial year ended 28 February 2013.



REQUIRED:

a) Define the term "fair value of an asset" according to *IFRS 13 – Fair value measurement.* (2½)

b) State the reasons why the transaction price and the fair value of an asset might differ on the initial recognition of an asset according to the requirements of *IFRS 13 – Fair value measurement*. (4½)



QUESTION 11 (55 marks)

Lawners Ltd is a manufacturer and retailer of garden tools and lawnmowers, with retail outlets across the country.

The newly appointed financial accountant has prepared draft financial statements of Lawners Ltd for the year ended 30 June 20.13. You are required to finalise these annual financial statements according to the requirements of *International Financial Reporting Standards (IFRSs)*. You are presented with the following information:

1. The profit **before** tax according to the draft financial statements of Lawners Ltd for the year ended 30 June 20.13 amounted to R1 150 000. The profit before tax includes the following items:

Income	**R**
Profit on sale of spray painting equipment	324 000
Expenses	
Depreciation – administration building (refer 4)	75 000
Depreciation – manufacturing building (refer 4)	100 000
Depreciation – manufacturing equipment (refer 4) (**including** spray painting equipment sold)	301 760

QUESTION 11 (continued)

2. The issued share capital of Lawners Ltd consists of 500 000 ordinary shares of R2 each. On 25 June 20.13 the directors declared a dividend of 10 cents per share for the year ended 30 June 20.13. The dividends as well as the dividend tax were paid on 10 July 20.13. The dividend transaction has **not** been recorded yet in the draft financial statements of Lawners Ltd for the year ended 30 June 20.13.

3. In order to increase the sales of its petrol chainsaws, Lawners Ltd decided on 1 July 20.10 to award 250 loyalty award credits to its customers for every petrol chainsaw purchased. The accounting policy of Lawners Ltd states that revenue attributable to the loyalty award credits should be allocated based on a relative stand-alone selling price basis. Loyalty award credits can be redeemed once an individual customer has accumulated 2 000 loyalty award credits. The loyalty award credits have no expiry date.

   During the current year's audit it was discovered that revenue relating to these petrol chainsaws was incorrectly recorded in the accounting records of Lawners Ltd for the current as well as the prior years. Revenue from these chainsaws was incorrectly recorded by also including the revenue attributable to the loyalty award credits immediately on delivery of the goods sold. Details of the total revenue recorded in the accounting records of Lawners Ltd relating to the petrol chainsaws for the respective financial years are as follows:

	20.13	**20.12**	**20.11**
	R	**R**	**R**
Revenue attributable to petrol chainsaws sold (allocated)	625 000	450 000	300 000
Revenue attributable to loyalty award credits (allocated)	115 400	81 000	54 000
Total revenue recorded in accounting records	740 400	531 000	354 000

   Since the introduction of the customer loyalty programme, none of the loyalty award credits have been redeemed to date due to the fact that individual customers did not acquire the required amount of loyalty award credits for redemption. You may assume that it is highly likely that customers will exercise all of their loyalty award credits. All petrol chainsaws are sold at a gross profit percentage of 25% on cost. The cost of sales relating to the petrol chainsaws has correctly been recorded in the accounting records of Lawners Ltd. No adjustment has been made in the accounting records of Lawners Ltd for the current and prior years, relating to the incorrect recording of the loyalty award credits, since its introduction.

4. The following schedule relating to the assets of Lawners Ltd is provided to you:

	Administration building	**Manufacturing building**	**Manufacturing equipment** (including spray painting equipment)
30 June 20.12	**R**	**R**	**R**
Carrying amount	1 200 000	2 100 000	1 868 800
Tax base	N/A	2 000 000	1 200 000

   On 1 September 20.12 the directors of Lawners Ltd decided to sell all the spray painting equipment and to rather lease advanced spray painting equipment required in the production process. On 30 September 20.12 the directors of Lawners Ltd sold the spray painting equipment for R780 000. The spray painting equipment was originally purchased on 1 July 20.10 for R750 000. The carrying amount and tax base of the spray painting equipment on 30 June 20.12 amounted to R480 000 and R450 000 respectively. The depreciation and tax allowance for the current year relating to all spray painting equipment sold during the year amounted to R24 000 and R150 000 respectively. No other manufacturing equipment was purchased or sold during the year.

QUESTION 11 (continued)

After the draft financial statements for the year ended 30 June 20.13 have been prepared, the directors of Lawners Ltd re-estimated the remaining useful life of manufacturing equipment (excluding the spray painting equipment) and determined that their remaining useful life, estimated from 1 July 20.12, is actually only 2 years. The straight line method will in future be applied on manufacturing equipment instead of the reducing balance method at 20% per annum. No adjustment has been made for this change in depreciation method in the draft financial statements of Lawners Ltd for the year ended 30 June 20.13.

The tax allowances for the year ended 30 June 20.13 on the manufacturing building and manufacturing equipment (including spray painting equipment sold) amounted to R125 000 and R800 000 respectively. The SA Revenue Service does not allow any tax allowance on the administration building.

5. Lazee Ltd, a regular customer of Lawners Ltd, operates a number of holiday resorts across the country. Lazee Ltd purchases all its garden tools and lawnmowers from Lawners Ltd. On 15 April 20.13 a lawnmower tractor's brakes failed and injured two holidaymakers, whilst playing golf at one of Lazee Ltd's holiday resorts. On 21 April 20.13 Lazee Ltd instituted a claim of R850 000 against Lawners Ltd for defective lawnmower tractors sold to Lazee Ltd. At year end on 30 June 20.13 the legal advisors of Lawners Ltd are of the opinion that it is probable that Lawners Ltd will not be found liable for the claim, due to insufficient maintenance of their lawnmower tractors by Lazee Ltd.

   The two injured holidaymakers were journalists at a national newspaper. Subsequent to the abovementioned incident, a headline news report titled "Lawnmower tractor injures holidaymakers" was published in this newspaper. This headline report adversely describes the quality of the lawnmower products manufactured and sold by Lawners Ltd. On 31 May 20.13, Lawners Ltd instituted a legal claim of R250 000 against this newspaper as a result of the negative publicity received by Lawners Ltd. On 30 June 20.13, the legal advisors of Lawners Ltd are of the opinion that it is probable, but not virtually certain, that Lawners Ltd will be successful with their claim.

The SA Normal tax rate remained unchanged at 28% for the past few years. The dividend tax rate is 15%. All capital gains are taxable at 80%.

The company provides deferred tax on all temporary differences using the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. There is certainty beyond any reasonable doubt that the company will have sufficient taxable profit in the future against which any deductible temporary differences can be utilised. Lawners Ltd has carried forward an assessed loss of R95 000 from the previous year.

Assume all amounts to be material.



REQUIRED:

a) Prepare the necessary journal entry for information **(2)** above to record the transaction in the accounting records of Lawners Ltd for the year ended 30 June 20.13.

   Your answer must comply with the requirements of *International Financial Reporting Standards (IFRSs)*.
   Do **not** use abbreviations for general ledger account names in your journals.
   Journal narrations are **not** required. (4)

b) Discuss, with reasons, if the dividends declared to the shareholders in information **(2)** above should be treated as a liability in the statement of financial position of Lawners Ltd at 30 June 20.13, according to the requirements of the *Conceptual Framework for Financial Reporting 2010*. (5)

c) Prepare the necessary correcting journal entry for information **(3)** above to record the transactions in the accounting records of Lawners Ltd for the year ended 30 June 20.13. Clearly indicate in your answer if it is a statement of financial position (SFP) or a statement of profit or loss and other comprehensive income (P/L) general ledger account.

Your answer must comply with the requirements of *International Financial Reporting Standards (IFRSs)*.
Do **not** use abbreviations for general ledger account names in your journals.
Journal narrations are **not** required.
Ignore the implications of tax and VAT. (3½)

d) Calculate the correct profit before tax in the statement of profit or loss and other comprehensive income of Lawners Ltd for the year ended 30 June 20.13, taking into account all the above mentioned information.

Your answer must comply with the requirements of *International Financial Reporting Standards (IFRSs)*. (3½)

e) Calculate the current tax expense of Lawners Ltd for the year ended 30 June 20.13, according to the requirements of *IAS 12 – Income taxes.* Use the profit before tax in the statement of profit or loss and other comprehensive income as calculated in **(d)** above as your starting point.

All calculations are to be done to the nearest Rand. (10)

f) Calculate the deferred tax balance in the statement of financial position of Lawners Ltd for the year ended 30 June 20.13, **using the statement of financial position approach**, according to the requirements of *IAS 12 – Income taxes.* Indicate if your answer is a deferred tax asset or deferred tax liability.

All calculations are to be done to the nearest Rand. (7)

g) Disclose information **(3)**, **(4)** and **(5)** above in the notes to the annual financial statements of Lawners Ltd for the year ended 30 June 20.13 according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors* and *IAS 37 – Provisions, contingent liabilities and contingent assets.*

No accounting policy notes are required. (16)

h) Currently Lawners Ltd values their buildings at historical cost but is considering valuing their buildings at fair value in future.

Please name the three most widely used valuation techniques that can be used to determine the fair value of the buildings according to *IFRS 13 – Fair value measurement*. (3)

i) According to *IFRS 13 – Fair value measurement*, the fair value measurement of the buildings should take into account a market participants ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

Please advise the financial accountant which three factors should be considered in determining the highest and best use of the buildings according to *IFRS 13 – Fair value measurement*. (3)



QUESTION 12 (45 marks)

Boxter Ltd is a company which manufactures and retails luxury sports cars and vehicle tracking systems. Boxter Ltd also acts as the sole distributor of ZY gearboxes in South Africa.

The profit before tax in the draft financial statements of Boxter Ltd for the year ended 28 February 2013 amounted to R2 360 000, **before** taking into account any adjustments which may be necessary as a result of the additional information below. On 25 April 2013 the board of directors reviewed the financial statements and authorised them for issue. The financial statements were approved at the annual general meeting held on 8 May 2013.

The SA Normal tax rate is 28%.

The company provides for deferred tax on all temporary differences using the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. There is certainty beyond any reasonable doubt that the company will have sufficient taxable profit in the future against which any deductible temporary differences can be utilised.

Assume all amounts are material.

Additional information

1. After a review of the draft financial statements of Boxter Ltd, the financial director of Boxter Ltd decided to change the current inventory valuation method from the weighted average method to the first-in, first-out method in order to ensure that more appropriate estimates of the value of inventory is ascertained. This change in accounting policy **has already been** recorded in the accounting records of Boxter Ltd for the year ended 28 February 2013. A summary of the effect on the cost of sales as a result of the change in inventory valuation is as follows:

Cost of sales according to the weighted average method:	**2013**	**2012**
	R	**R**
Cost of sales	829 500	780 000
Opening inventory	355 000	335 000
Purchases	960 500	800 000
	1 315 500	1 135 000
Closing inventory	(486 000)	(355 000)

Cost of sales according to the first-in, first-out method:	**2013**	**2012**
	R	**R**
Cost of sales	787 500	750 000
Opening inventory	510 000	460 000
Purchases	960 500	800 000
	1 470 500	1 260 000
Closing inventory	(683 000)	(510 000)

The SA Revenue Service indicated that they will **not** re-open the previous year's tax assessments and that they will **not** accept the current inventory valuation method for tax purposes.

QUESTION 12 (continued)

2. The following transactions have **not** been recorded yet in the accounting records of Boxter Ltd for the year ended 28 February 2013:

   2.1 Boxter Ltd is entitled to a commission of 20% on all their sales of ZY gearboxes, excluding bad debts. Boxter Ltd is not exposed to inventory risk as ZY Ltd is primarily responsible for delivering the ZY gearboxes. During the year ended 28 February 2013, Boxter Ltd sold 2 155 ZY gearboxes to third parties for R1 385 each. At 28 February 2013 an amount of R17 500 was still outstanding from third parties in respect of ZY gearboxes sold, which is highly unlikely to be recovered as it has been outstanding for more than 6 months. Commission is annually payable in cash, one month after year end.

   2.2 On 1 February 2013 Boxter Ltd sold a Layman sportscar, including a service plan, for R750 000 cash to a customer. These cars are sold at cost plus 25%. A customer may also acquire a Layman sportcar without a service plan for R730 000. Boxter Ltd regularly sells two year service plans to customers on a stand-alone basis for R25 000.

3. Boxter Ltd sells their vehicle tracking systems with a two year mechanical warranty. You may assume that the warranty cannot be purchased separately and does not provide the customer with a service in addition to the assurance. Boxter Ltd makes a provision in its annual financial statements for these future warranty costs to repair defective vehicle tracking systems returned by customers. The provision for warranty costs is not deductible for tax purposes, but the actual warranty costs paid are deductible. Based on past experience it is estimated that 12% of the vehicle tracking systems sold are returned with defects that has to be repaired. The balance of the provision for warranty costs in the draft financial statements of Boxter Ltd on 29 February 2012 and 28 February 2013 amounted to R212 000 and R307 000 respectively. Actual warranty costs paid during the current year amounted to R100 911 (2012: R30 300) and was debited against the provision for warranty costs. The balance of the provision for warranty costs on 28 February 2011 amounted to Rnil.

4. During February 2013 Boxter Ltd relocated its manufacturing plant in Port Elizabeth to Cape Town. This relocation will result in an annual saving of manufacturing costs of at least R500 000 in the future. The current lease agreement of the manufacturing plant in Port Elizabeth stipulates that early termination of the agreement would result in a penalty of 50% of the remaining lease payments due, payable in cash within three months after termination of the agreement. The current lease agreement of the manufacturing plant in Port Elizabeth terminates on 31 August 2013. The lease payments of R30 000 per month for the year ended 28 February 2013 have been paid to date.

   On 31 March 2013, after successfully relocating the manufacturing plant to Cape Town, the eastern side of the manufacturing plant was destroyed in a fire, caused by the defective installation of electrical wiring during the relocation. Damage to the plant was estimated at R500 997 of which R10 997 related to damaged inventory manufactured during March 2013. The company's insurance policy does not cover this contingency and the claim was repudiated by the insurance company. A contract was concluded with VolksWerkers Ltd to repair the eastern side of the manufacturing plant in Cape Town at a cost of R500 000.



REQUIRED:

a) Prepare all the necessary journal entries for additional information **(2)** above in the accounting records of Boxter Ltd **only** for the year ended 28 February 2013.

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

   Journal narrations are **not** required.
   No abbreviations for general ledger account names in your journal must be used.
   Indicate in your journal if it is a statement of financial position (SFP) or statement of profit or loss and other comprehensive income (P/L) general ledger account.
   Ignore the implications of tax and VAT. (10½)

QUESTION 12 (continued)

b) Calculate the deferred tax balance in the statement of financial position of Boxter Ltd for the year ended 28 February 2013 using the **statement of financial position approach,** according to the requirements of *IAS 12 – Income taxes*. Indicate if the balance is a deferred tax asset or liability. (6)

c) Disclose additional information **(1), (3) and (4)** above in the notes to the annual financial statements of Boxter Ltd for the year ended 28 February 2013, according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors, IAS 10 – Events after the reporting period* and *IAS 37 – Provisions, contingent liabilities and contingent assets.*

Ignore the implications of VAT.
Comparative figures **are** required.
No other notes are required.
No accounting policy notes are required. (28½)



QUESTION 13 (53 marks)

Kitchen Supply Ltd is a manufacturer of wooden kitchen cupboards. These cupboards can either be installed by Kitchen Supply Ltd at the premises of customers or purchased from Kitchen Supply Ltd as do-it-yourself kits.

1. The profit before tax in the draft statement of profit or loss and other comprehensive income of Kitchen Supply Ltd for the year ended 28 February 20.14 amounted to R960 000, which **includes** the following:

	R
Income	
Profit on sale of machinery (refer 10)	66 000
Foreign income received from the United Kingdom (Kitchen Supply Ltd paid foreign taxes of R5 000 on this income)	20 000
Expenses	
Legal fees (40% tax deductible)	15 000
Depreciation	470 000
Depreciation: administration building	100 000
Depreciation: delivery vehicles (before change in depreciation rate)	150 000
Depreciation: machinery	220 000
Fine paid to Department of Trade and Industry	25 000
Claims – Designer Kitchen Ltd (refer 5)	90 000

2. On 15 January 20.14, a customer instituted a claim of R50 000 against Kitchen Supply Ltd for what he claimed to be a sub-standard installation. All installations carried out by Kitchen Supply Ltd are subject to strict quality control inspections. On the 28 February 20.14 year end the legal advisors of Kitchen Supply Ltd were of the opinion that it is not probable that Kitchen Supply Ltd will be found liable for the claim, as the installation met all the quality control specifications at the time of the installation.

3. During February 20.14, a deposit of R40 000 was received from a customer for the installation of wooden kitchen cupboards. The wooden kitchen cupboards will only be installed in March 20.14 after the customer has plastered the kitchen walls. This deposit was correctly accounted for in the accounting records of Kitchen Supply Ltd for the year ended 28 February 20.14.

QUESTION 13 (continued)

4. On 1 January 20.13 and 1 January 20.14, Kitchen Supply Ltd paid the insurance premiums which are payable annually in advance amounting to R90 000 and R110 000 respectively. The balances of the prepaid insurance premium in the statement of financial position of Kitchen Supply Ltd on 28 February 20.13 and 28 February 20.14, which you may assume to be correct, amounted to R50 000 and R80 000 respectively.

5. On 18 February 20.14, Designer Kitchen Ltd instituted a claim of R90 000 against Kitchen Supply Ltd for the duplication of kitchen cupboard designs, similar to those manufactured by Designer Kitchen Ltd. Kitchen Supply Ltd's legal advisors are of the opinion that judgement will probably be in favour of Designer Kitchen Ltd and the directors subsequently raised a provision for this claim in the draft financial statements of Kitchen Supply Ltd for the year ended 28 February 20.14.

6. The following information is an extract from the asset register of Kitchen Supply Ltd on the respective dates:

Description	Cost	Carrying amount	Tax base
On 28 February 20.13:	**R**	**R**	**R**
Administration building	2 000 000	1 800 000	-
Delivery vehicles	750 000	450 000	375 000
Machinery	1 100 000	880 000	825 000

Description	Cost	Carrying amount	Tax base
On 28 February 20.14:	**R**	**R**	**R**
Administration building	2 000 000	1 700 000	-
Delivery vehicles	750 000	300 000	187 500
Machinery	960 000	576 000	480 000

You may assume that the above details of the assets of Kitchen Supply Ltd are correct **before** taking into account the change in depreciation rate (refer 8) and the incorrect recording of air conditioners purchased for use in the administration building (refer 9).

7. The following depreciation rates and tax allowances are applicable:

	Depreciation rate	Tax allowance
Administration building	5% p.a. straight-line	-
Delivery vehicles (before rate change)	20% p.a. straight-line	4 years straight-line
Machinery	20% p.a. straight-line	4 years straight-line
Air conditioners	20% p.a. straight-line	4 years straight-line

8. The delivery vehicles of Kitchen Supply Ltd are used to transport kitchen cupboards sold to customers. All the delivery vehicles were originally acquired on 1 March 20.11 and immediately put into use on this date. No delivery vehicles have been sold or purchased since then. After a review of the physical condition of the company's assets at year end, the financial manager of Kitchen Supply Ltd determined that the depreciation rate used for delivery vehicles was incorrectly estimated. The useful lives of delivery vehicles are actually shorter than originally estimated. As a result thereof, the directors of Kitchen Supply Ltd decided to change the depreciation rate used for delivery vehicles to 25% per annum, according to the straight-line method. The effect of this change has not yet been recorded in the company's accounting records for the year ended 28 February 20.14.

9. While performing the reconciliation of the asset register for the current financial year, it was discovered that air conditioners purchased and installed in the administration building on 1 March 20.12 were incorrectly recorded. The cost of R180 000 was incorrectly expensed as repairs in the statement of profit or loss and other comprehensive income of Kitchen Supply Ltd for the year ended 28 February 20.13. The effect thereof is considered material and no adjustment has yet been recorded in the accounting records of Kitchen Supply Ltd. The South African Revenue Service has agreed to reopen the 20.13 tax assessment.

QUESTION 13 (continued)

10. Kitchen Supply Ltd acquired all their machinery on 1 March 20.12 and it was immediately put into use on this date. On 28 February 20.14 certain obsolete machinery with a cost of R140 000 was withdrawn from the manufacturing process and sold for R150 000. On this date the carrying amount and tax base of this machinery amounted to R84 000 and R70 000 respectively. This sale has already been recorded in the accounting records of Kitchen Supply Ltd for the year ended 28 February 20.14. No other machinery was acquired or sold since 1 March 20.12.

11. The SA Normal tax rate remained unchanged at 28%. 80% of all capital gains are taxable. On 31 August 20.13 and 28 February 20.14, Kitchen Supply Ltd paid R60 000 and R50 000 respectively, in respect of provisional tax for the financial year ended 28 February 20.14.

12. Deferred tax is provided for on all temporary differences, using the statement of financial position approach. There are no other exempt or temporary differences except those mentioned in the question. It is probable that future taxable profits will be available against which any deductible temporary differences can be utilised.

13. Assume all amounts to be material.



REQUIRED:

a) **Identify** the relevant **elements** of financial statements in the information provided in point 5 above in the financial statements of Kitchen Supply Ltd for the year ended 28 February 20.14 and state the **recognition criteria** of these elements.

Your answer must comply with the requirements of the *Conceptual Framework for Financial Reporting 2010*. (5)

b) Calculate the correct profit before tax in the statement of profit or loss and other comprehensive income of Kitchen Supply Ltd for the year ended 28 February 20.14, taking into account all the above information.

Your answer must comply with the requirements of *International Financial Reporting Standards (IFRSs)*. (3)

c) Calculate the current tax due by Kitchen Supply Ltd to the SA Revenue Service for the year ended 28 February 20.14. Use the profit before tax calculated in **(b)** above as your starting point.

All calculations are to be done to the nearest Rand. (15½)

d) Calculate the deferred tax balance in the statement of financial position of Kitchen Supply Ltd as at 28 February 20.14, **using the statement of financial position approach,** according to the requirements of *IAS 12 – Income taxes*. Indicate if the balance is a deferred tax asset or deferred tax liability.

All calculations are to be done to the nearest Rand. (10)

e) Disclose the tax rate reconciliation, using the **R-values only**, in the annual financial statements of Kitchen Supply Ltd for the year ended 28 February 20.14, according to the requirements of *IAS 12 – Income Taxes.* (6½)

QUESTION 13 (continued)

	f) Disclose information **(2)**, **(8)** and **(9)** above in the notes to the annual financial statements of Kitchen Supply Ltd for the year ended 28 February 20.14, according to the requirements of **only** *IAS 8 – Accounting policies, changes in accounting estimates and errors* and *IAS 37 – Provisions, contingent liabilities and contingent assets*. All calculations must me shown. **No** comparative figures are required. **No** accounting policy notes are required. All calculations are to be done to the nearest Rand. (13)



QUESTION 14 (47 marks)

Squad Cars Ltd is a retailer of go-karts for kids and adults. The profit before tax of Squad Cars Ltd for the year ended 28 February 2014 amounted to R950 000, **before** taking into account the following transactions which have **not** yet been recorded in the accounting records of Squad Cars Ltd:

1. On 10 February 2014, an invoice was received from Mr Handyman, for repair work done to the security fence surrounding the warehouse of Squad Cars Ltd. Mr Handyman was compensated for the repairs by exchanging a go-kart for his services rendered. The fair value of the repairs to the security fence amounted to R45 000, whilst the selling price and cost price of the go-kart exchanged amounted to R48 000 and R43 000 respectively.

2. On 5 January 2014, a customer, Mr Surprise, bought a go-kart on lay-away for his son. The selling price of this go-kart amounted to R18 000 with a gross profit of 30% on the selling price. On this date Mr Surprise paid R15 000 as a deposit and agreed to pay the outstanding balance on the birthday of his son on 10 April 2014. Squad Cars Ltd will transfer control of the go-kart to Mr Surprise on 10 April 2014.

3. The service contracts of the sales personnel of Squad Cars Ltd stipulates that they are entitled to a monthly sales bonus of 1,5% of their monthly sales if the total monthly sales of Squad Cars Ltd exceeds R300 000. The total sales of Squad Cars Ltd for the month of February 2014 amounted to R320 000.

4. Squad Cars Ltd provides a three month guarantee on all its battery operated go-karts sold. You may assume that the guarantee cannot be purchased separately and does not provide the customer with a service in addition to the assurance. The company will repair these defective battery operated go-karts free of charge if they are returned within the guarantee period. There is an agreement between Squad Cars Ltd and the supplier of these battery operated go-karts, to recoup 60% of the repair costs incurred by Squad Cars Ltd from the supplier. This recoupment from the supplier is virtually certain. If minor defects are detected in **all** the battery operated go-karts sold, repair costs of R600 000 would result. If major defects are detected in **all** battery operated go-karts sold, repair costs of R1 million would result. Past experience indicates that 60% of the battery operated go-karts sold, will have no defects, 35% will have minor defects and 5% will have major defects.

5. During January 2013, the previous managing director of Squad Cars Ltd, Mr Union, decided to resign. Consequently, the financial manager of Squad Cars Ltd raised a provision of R180 000 in the accounting records for the year ended 28 February 2013 for the severance package to be paid out to Mr Union. In July 2013 the directors decided to pay Mr Union R40 000 in the meantime, whilst finalising the dispute about the severance package with Mr Union. During November 2013 Mr Union decided to settle the dispute and an amount of R130 000 was paid to him as final settlement.

QUESTION 14 (continued)

6. After the draft financial statements of Squad Cars Ltd for the year ended 28 February 2014 had been prepared, the directors decided at a board meeting held on 10 March 2014 to change the current valuation method of inventory from the last-in, first-out method to the first-in, first-out method. This was decided in order to comply with *International Financial Reporting Standards (IFRSs)* and to give a more reliable value of inventory on hand. The following is a summary of the inventory valuations of Squad Cars Ltd on the respective dates:

	First-in, first-out method	**Last-in, first-out method**	**Difference**
	R	**R**	**R**
28 February 2014	420 000	414 000	6 000
28 February 2013	402 000	394 000	8 000
29 February 2012	391 000	380 000	11 000

The SA Revenue Service indicated that they will **not** re-open the previous years' tax assessments but that they will accept the new inventory valuation method for the current and future years for tax purposes.

7. On 10 April 2014, Squad Cars Ltd was successful in obtaining a second mortgage bond of R320 000 at an interest rate of 10% per annum, from CAT Bank Ltd, in order to finance the expansion of its trading premises. The land and buildings serve as security for the mortgage bond.

The financial statements of Squad Cars Ltd for the year ended 28 February 2014 were presented to the board of directors for authorisation for issue on 30 April 2014.

The SA Normal tax rate has remained unchanged for the past few years at 28%.

Assume all amounts to be material.



REQUIRED:

a) Prepare the journal entries in the accounting records of Squad Cars Ltd for transactions **(1) to (4)** above **only** for the year ended 28 February 2014. Clearly indicate in your answer if the item is a statement of financial position (SFP) or a statement of profit or loss and other comprehensive income (P/L) general ledger account.

No abbreviations for the general ledger account names in your journals may be used.
No journal narrations are required.
Ignore all tax implications.
Show all your calculations. (15)

b) With reference to transaction (4) above, prepare the relevant note to the annual financial statements of Squad Cars Ltd for the year ended 28 February 2014, if it is expected that the recoupment from the suppliers is **probable but not virtually certain**. The returned battery operated go-karts will first be inspected by the supplier to determine if the cause of the repairs arose from a manufacturing defect, before any refunds are made. Your answer must comply with the requirements of *IAS 37 – Provisions, contingent liabilities and contingent assets*.

Accounting policy notes are **not** required. (2½)

	c) Disclose transactions **(5), (6)** and **(7)** above in the notes to the annual financial statements of Squad Cars Ltd for the year ended 28 February 2014 according to the requirements *of IAS 8 – Accounting policies, changes in accounting estimates and errors, IAS 10 – Events after the reporting period* and *IAS 37 – Provisions, contingent liabilities and contingent assets.* **No** accounting policy notes are required. Comparative figures are required. (24) d) Squad Cars Ltd owns a warehouse in Benoni from where it distributes its inventory to its Gauteng branches. The warehouse of Squad Cars Ltd has always been valued at historical cost. However, the accountant of Squad Cars Ltd wants to value the warehouse for the first time on 28 February 2014 at fair value. Define the fair value of an asset and state the characteristics of an asset that should be taken into account when determining the fair value of an asset, according to *IFRS 13 – Fair value measurement.* (5½)

SUGGESTED SOLUTIONS TO ADDITIONAL INTEGRATED QUESTIONS



SUGGESTED SOLUTION QUESTION 1

a) **Relevant Revenue Journal Entries**

	Debit R	Credit R
20.09		
Accounts receivable (SFP) (25% x 200 000)	50 000	
Revenue (P/L)		50 000
Recording revenue - progress towards complete satisfaction		
20.10		
Bank (SFP)	200 000	
Accounts receivable (SFP)		50 000
Revenue (P/L) (200 000 – 50 000)		150 000
Recording revenue - complete satisfaction of performance obligation		

b) **In terms of the definition of an expense it represents:**

- A decrease in economic benefits;
- During the accounting period;
- In the form of outflows (through a decrease (depletion) in assets or an increase (incurrence) in liabilities);
- That result in decreases in equity.(par. 4.25 (b))

Recognition criteria for an expense:

- Recognised in the statement of profit or loss and other comprehensive income when a decrease in future economic benefit related to a decrease in an asset or an increase of a liability has arisen;
- That can be measured reliably.(par. 4.49)

Discussion of the expense:

- The amount of the payment is reliably measured in terms of a contract.
- The payment for the repairs is made during the current accounting period.
- There is a decrease in the bank (assets).
- There is a decrease in equity and therefore the payment could be expensed.

Conclusion:
The payment for the repairs of the furniture meets both the definition and recognition criteria and therefore should be expensed in the statement of profit or loss and other comprehensive income.



HOW SHOULD I APPROACH THIS QUESTION ON THE CONCEPTUAL FRAMEWORK?

First, state the definition and recognition criteria of an expense. You should know the definitions and recognition criteria of all the elements of the financial statements.

After stating the definition and recognition criteria, consider whether the item complies with the definition of an expense and then test the item against the recognition criteria.

Finally, conclude whether the item should be recognised as an expense.

SOLUTION QUESTION 1 (continued)

c) **Calculation of current tax expense for the year ended 30 September 20.10**

	R
Profit before tax	1 450 000
Change in accounting policy – accounting (50 000 – 48 000)	2 000
Adjusted profit before tax	1 452 000
Exempt differences:	88 000
Depreciation – administration building	90 000
Capital gain of machine [(290 000 – 280 000) x (100% – 80%)]	(2 000)
Profit after exempt differences	1 540 000
Temporary difference:	202 200
Depreciation (150 000 + 74 000)	224 000
Tax allowance (150 000 + 92 500)	(242 500)
Profit on sale of asset (280 000 – 210 000)	(70 000)
Recoupment on sale of asset (280 000 – 192 500)	87 500
Provision – onerous contract ((3 500 x 12) x 60%)	25 200
Agency fees – contract liability	180 000
Change in accounting policy – accounting (50 000 – 48 000)	(2 000)
Change in accounting policy – tax	50 000
Actual repairs incurred (given)	(200 000)
Repairs debited to P/L [200 000 – (200 000 x 25%)]	150 000
Taxable income	1 742 200
Less: Assessed loss	(130 000)
Taxable income	1 612 200
Current tax @ 28% (R1 612 200 x 28%)	451 416
Provisional tax payments (110 000 + 70 000)	(180 000)
Amount due to the SA Revenue Service	271 416



HOW SHOULD I RECORD THE CURRENT TAX EXPENSE AND THE PROVISIONAL TAX PAYMENTS?

The following journal entries should be prepared for the year ended 30 September 20.10:

	Dr	Cr
31 March 20.10	**R**	**R**
SA Revenue Service / Current tax payable (SFP)	110 000	
Bank (SFP)		110 000
Recording the first provisional tax payment for the year		
30 September 20.10		
Current tax expense (P/L)	451 416	
SA Revenue Service / Current tax payable (SFP)		451 416
Recording current tax expense for the current year		
SA Revenue Service / Current tax payable (SFP)	70 000	
Bank (SFP)		70 000
Recording the second provisional tax payment for the year		

SOLUTION QUESTION 1 (continued)

EXPLANATION: CAPITAL GAIN, PROFIT ON SALE AND RECOUPMENT ON SALE

If the selling price (SP) (proceeds on sale) is higher than the original cost price (CP) of the asset sold, then:

- the difference between the SP and the CP is a capital profit, of which 80% is taxable in the case of companies and which results in an exempt difference for deferred tax purposes;
- the difference between the CP and the carrying amount (CA) is a profit on sale which results in a temporary difference for deferred tax purposes.

Profit before tax should be adjusted as follows to calculate taxable income:

- the 20% of the capital profit which is not taxable should be deducted from profit before tax, therefore the 80% is included in taxable income;
- the accounting profit (CP – CA) should be deducted from profit before tax and the recoupment of tax allowances (CP – tax base) should be added to profit before tax, therefore excluding accounting profit from taxable income and including recoupment in taxable income

EXPLANATION: CHANGE IN ACCOUNTING POLICY

Before answering a question about a change in accounting policy it is important to determine the following:

1. Will the SA Revenue Service reopen the previous years' tax assessments?
2. Will the SA Revenue Service accept the new accounting policy?

In this question the change in accounting policy is accepted by the SA Revenue Service, but the previous years' tax assessments will not be re-opened.

For tax purposes the change in accounting policy will not affect taxable income in the prior periods and the cumulative effect of the change in accounting policy will be included in taxable income in the current period.

For accounting purposes the change in accounting policy is retrospectively adjusted in profit before tax as the period-specific effects are available. In the calculation of taxable income, the period-specific effect that is included in profit before tax should first be excluded from profit before tax, before the cumulative effect is taken into account.

d) **Calculation of deferred tax balance**

	Carrying amount	**Tax base**	**Temporary difference**	**Deferred tax asset/ (liability) @ 28%**
20.09	**R**	**R**	**R**	**R**
Provision for repairs (25% x 200 000)	50 000	-	50 000	14 000
Inventory	344 000	296 000	48 000	(13 440)
Machinery	224 000[1]	210 000[2]	14 000	(3 920)
Assessed loss	-	130 000	130 000	36 400
Deferred tax asset				33 040
20.10				
Machinery	340 000	325 000	15 000	(4 200)
Agency fees – contract liability	180 000	-	180 000	50 400
Provision – onerous contract	25 200[3]	-	25 200	7 056
Deferred tax asset				53 256

[1] 280 000 – (280 000 x 20%)
[2] 280 000 – (280 000 x 25%)
[3] (3 500 x 12) x 60%

SOLUTION QUESTION 1 (continued)



HOW SHOULD I RECORD THE DEFERRED TAX MOVEMENT?

The following journal entry should be prepared to record the deferred tax movement for the year ended 30 September 20.10 (the general ledger account is shown below):

	Dr R	Cr R
Deferred tax (SFP)	20 216	
Deferred tax expense (P/L) (53 256 – 33 040)		20 216
Recording deferred tax movement for the current year		

Dr		Deferred tax (SFP)			Cr
01/10/20.09 Opening balance	b/d	33 040			
30/09/20.10 Deferred tax expense (P/L)		20 216	30/09/20.10 Closing balance	c/d	53 256
		53 256			53 256
01/10/20.10 Opening balance	b/d	53 256			

Dr	Deferred tax expense (P/L)	Cr
	30/09/20.10 Deferred tax (SFP)	20 216



LECTURER'S COMMENT

Remember that the opening debit balance of the deferred tax account amounted to R33 040 and that the closing debit balance amounted to R53 256. The journal records the **movement** between the opening and closing balances of the deferred tax account in the accounting records of LTea Ltd.

	R
Closing deferred tax balance	53 256
Opening deferred tax balance	33 040
Movement (53 256 – 33 040) (Debit to deferred tax asset (SFP))	20 216

EXPLANATION: PROVISION, INVENTORY AND ASSESSED LOSS

- The tax base (TB) of the **provision for repairs** is equal to the carrying amount (CA) less the amount deductible for tax purposes in future (50 000 – 50 000)). The TB represents two amounts, namely the liability for repair costs of R50 000 and the tax allowance of R50 000 still due as a deduction from tax in the future.

  The TB of the **provision for the onerous contract** is equal to the CA less the amount deductible for tax purposes in future (25 200 – 25 200)). The TB represents two amounts, namely the liability for penalty of R25 200 and the tax allowance of R25 200 still due as a deduction from tax in the future.

  Rule 4: CA of the liability > TB of the liability = DEFERRED TAX ASSET (SFP)

- **Inventory** is not included in the calculation of the deferred tax balance at 30 September 20.10 as the SA Revenue Service indicated that they will accept the new inventory valuation method from the current year. At 30 September 20.09 the carrying amount of inventory is based on the first-in, first-out method and the tax base of inventory is based on the last-in, first-out method and therefore there is a temporary difference. At 30 September 20.10 both the carrying amount and the tax base of inventory are based on the first-in, first-out method of inventory valuation and there is no temporary difference.

  Rule 1: CA of the asset > TB of the asset = DEFERRED TAX LIABILITY (SFP)

SOLUTION QUESTION 1 (continued)

EXPLANATION: PROVISION, INVENTORY AND ASSESSED LOSS (continued)
• If the current tax calculation results in an **assessed loss**, the benefit of the assessed loss should be fully recognised in the deferred tax calculation in the year in which it originates. The benefit of the assessed loss for 20.09 is however not included in the calculation of the deferred tax balance at 30 September 20.10 as the assessed loss was fully utilised against taxable income for the year ended 30 September 20.10 (refer to (c) above). **Rule 3: CA of the asset < TB of the asset = DEFERRED TAX ASSET (SFP)**

e) **Tax rate reconciliation**

	R
Standard rate of tax (1 452 000 x 28%)	406 560
Adjusted for exempt differences:	
Depreciation – administration building (90 000 x 28%)	25 200
Capital profit on sale of machinery (2 000 x 28%)	(560)
	431 200



LECTURER'S COMMENT

The income tax expense in the statement of profit or loss and other comprehensive income should have been R406 560 (1 452 000 x 28%). The income tax expense is currently shown as R431 200 (451 416 – 20 216). The reason for the difference is that exempt differences do not have any tax consequences. IAS 12 requires a reconciliation of the relationship between the tax expense and profit before tax (accounting profit) multiplied by the applicable tax rate.

f) **LTEA LTD**
NOTES FOR THE YEAR ENDED 30 SEPTEMBER 20.10

1. **Change in accounting policy**
During the year the company changed its accounting policy in respect of the valuation of inventory from the last-in, first-out method to the first-in, first-out method. This change was necessary to ensure that the company complies with International Financial Reporting Standards (IFRS). The change in policy was accounted for retrospectively and comparative amounts have been appropriately restated. The effect of this change is as follows:

	20.10 **R**	**20.09** **R**	**1/10/20.08** **R**
Decrease in cost of sales			-
(50 000 – 48 000); (48 000 – 40 000)	2 000	8 000	
Increase in income tax expense			-
(2 000 x 28%); (8 000 x 28%)	(560)	(2 240)	
Increase in profit	1 440	5 760	-
Increase in inventory	50 000	48 000	40 000
Increase in current tax liability/SA Revenue Service			
(50 000 x 28%)	(14 000)	-	-
Increase in deferred tax liability			
(48 000 x 28%);(40 000 x 28%)	-	(13 440)	(11 200)
Increase in equity	36 000	34 560	28 800
Adjustment to retained earnings at the beginning of 20.09			
(40 000 x 72%)			28 800

SOLUTION QUESTION 1 (continued)



REMEMBER

The increase in both the opening and closing inventory result in a decrease of cost of sales, and an increase in the profit.

	20.10 R	20.09 R
Cost of sales	(2 000)	(8 000)
Opening inventory	48 000	40 000
Purchases	xxx	xxx
Closing inventory	(50 000)	(48 000)



LECTURER'S COMMENT

For prior periods the carrying amount of inventory is based on the first-in, first-out method and the tax base of inventory is based on the last-in, first-out method, resulting in temporary differences for deferred tax purposes. Therefore the deferred tax line item in the statement of financial position and the statement of profit or loss and other comprehensive income are restated for the comparative periods.

However, in the current period both the carrying amount and the tax base of inventory are based on the first-in, first-out method of inventory valuation and therefore there is no temporary difference for deferred tax purposes.

Calculation of deferred tax relating **only** to inventory:

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax balance Dr/(Cr) @28% R	Deferred tax movement Dr/(Cr) R
20.08	230 000	190 000	40 000	(11 200)	11 200
20.09	344 000	296 000	48 000	(13 440)	2 240
20.10	355 000	355 000	–	–	(13 440)



HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING POLICY?

Both the cumulative and period-specific effect for all comparative periods are available, therefore the change in accounting policy can be applied retrospectively. Retrospective application requires a new accounting policy to be applied to transactions **as if that policy has always been applied.** The following journal entries should be prepared to record the change in accounting policy:

Please note: The following current and deferred tax journals relate only to the tax implications of inventory.

	Dr R	Cr R
1 October 20.08		
Inventories (SFP)	40 000	
Deferred tax (SFP)		11 200
Retained earnings (Equity)		28 800
Restate the earliest period presented for the cumulative effect of the change in accounting policy		
30 September 20.09		
Inventories (SFP)	8 000	
Cost of sales (P/L)		8 000
Restate the period specific effect of the change in accounting policy for 20.09		

SOLUTION QUESTION 1 (continued)

HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING POLICY? (continued)		
	Dr R	**Cr R**
Deferred tax expense (P/L)	2 240	
Deferred tax (SFP)		2 240
Tax effect for the period specific effect of the change in accounting policy for 20.09		
30 September 20.10		
Inventories (SFP)	2 000	
Cost of sales (P/L)		2 000
Restate the period specific effect of the change in accounting policy for 20.10		
Deferred tax (SFP)	13 440	
Deferred tax expense (P/L)		13 440
Current tax expense (P/L)	14 000	
Current tax payable / SA Revenue Service (SFP)		14 000
Tax effect for the period specific effect of the change in accounting policy for 20.10		



SUGGESTED SOLUTION QUESTION 2

a) **Correcting journal entry**

	Debit R	Credit R
Provision for warranty costs [100 000 – (400 000 x 6%) – (800 000 x 4%)]	44 000	
Warranty Costs		44 000
Recording of change in warranty provision due to change in estimate		

b) **Calculation of profit before tax**

	2011 R	2010 R
Profit before tax (given)	980 000	890 000
Security services incorrectly allocated (120 000 x $^{8}/_{12}$);(120 000 x $^{4}/_{12}$)	(80 000)	(40 000)
Provision for warranties [100 000 – (6% x 400 000) – (4% x 800 000)]	44 000	-
Bad debts written off – neighbouring warehouse (60 000 x (100 - 20))	(48 000)	-
Consignment sales (20 000 x $^{100}/_{80}$ x (100 – 60))	10 000	-
Cost of sales (20 000 x (100 – 60))	(8 000)	-
Sales recognised at fair value of non-cash consideration – tyre tubes	80 000	-
Cost of sales on wheel alignment machine (given)	(70 000)	-
Sales – COD sales (22 000 x 70%)	15 400	-
Cost of sales – COD sales (16 000 x 70%)	(11 200)	-
	912 200	850 000

c) **Calculation of deferred tax balance at 28 February 2011**

	Carrying Amount R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) @28% R
COD sales contract liability	6 600[1]	-	6 600	1 848
Provision for warranties	56 000[2]	-	56 000	15 680
Deferred tax asset				17 528

[1] 22 000 x (100% - 70%)

[2] (400 000 x 6%) + (800 000 x 4%)

EXPLANATION: PROVISION

The tax base (TB) of the **provision for warranty** is equal to the carrying amount (CA) less the amount deductible for tax purposes in future (56 000 – 56 000)). The TB represents two amounts, namely the liability for warranty costs of R56 000 and the tax allowance of R56 000 still due as a deduction from tax in the future.

Rule 4: CA of the liability > TB of the liability = DEFERRED TAX ASSET (SFP)

d) **STONERIDGE LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 2011

1. **Profit before tax**
Change in warranty provision
Included in profit before tax is a change in accounting estimate that arose from the decision to change the estimates used as a basis for making the provision for warranty costs due to the results of recent quality control surveys. This change in estimate resulted in a decrease in provision for warranty claims created of R44 000. The cumulative effect of this on future periods is unknown.

SOLUTION QUESTION 2 (continued)



LECTURER'S COMMENT

Only the provision for warranty costs for the current year, i.e. 28 February 2011, should reflect the **newest** estimate. The change in estimate should be applied prospectively.

2. **Prior year error**

Correction of security expenses incorrectly accounted for as debtors. The comparative amounts have been appropriately restated. The effect of this error on the results of 2010 is as follows:

	2010 R
Increase in expenses (120 000 x $^{4}/_{12}$)	40 000
Decrease in tax expense (40 000 x 28%)	(11 200)
Decrease in profit	28 800
Decrease in accounts receivable	120 000
Increase in expenses prepaid (120 000 x $^{8}/_{12}$)	(80 000)
	40 000
Decrease in current tax liability/SA Revenue Service (40 000 x 28%)	(11 200)
Decrease in equity	28 800



HOW SHOULD I RECORD THE ERROR?

The error occurred in the prior year therefore the comparative amounts are restated**.** The following journal entries should be prepared to correct the error:

28 February 2010	**Dr** **R**	**Cr** **R**
Security expenses (P/L)	40 000	
Prepaid expenses (SFP)	80 000	
Accounts receivable (SFP)		120 000
Correction of payment for security services incorrectly allocated to accounts receivable account in 2010		
Current tax payable / SA Revenue Service (SFP)	11 200	
Current tax expense (P/L)		11 200
Tax effect of correction of error in 2010		

3. **Provision for warranty cost**

	2011 **R**	**2010** **R**
Carrying amount – beginning of the year	120 000	80 000
Amount used during the year	(90 000)	(70 000)
Reversal of unused provision (120 000 - 90 000), (80 000 - 70 000)	(30 000)	(10 000)
Provision created for the year (6% x 400 000) + (4% x 800 000)	56 000	120 000
Carrying amount – end of year	56 000	120 000

A provision of R56 000 has been recognised for the current year for expected warranty costs for tyres sold based on recent quality control surveys.

SOLUTION QUESTION 2 (continued)

	**LECTURER'S COMMENT**

In terms of IAS 37.14, a provision is only recognised when:

- the entity has a present **legal** or **constructive** obligation to forfeit economic benefits as a result of events in the past ("whether it complies")
- it is **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation ("when"); and
- a **reliable estimate** of the obligation can be made ("how much").

4. **Events after reporting period**
   Contracts for capital expenditure/repairs
   On 1 April 2011 a contract was concluded with Max Contractors Ltd to repair damages to a warehouse for R100 000 due to labour unrest.

	**LECTURER'S COMMENT**

Non-adjusting events after the reporting period are those events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue that are indicative of conditions that arose after the reporting period.

Amounts recognised in the financial statements should not be adjusted to reflect non-adjusting events after the reporting period, however if the effect of the non-adjusting event is material both the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made should be disclosed.

5. **Contingent liability**
   During the year, the employees trade union of Stoneridge Ltd instituted a claim of R55 000 for dismissal of its three employees. At year end the lawyers of Stoneridge Ltd have indicated that the claim against Stoneridge Ltd will probably not succeed.

	**LECTURER'S COMMENT**

The claim for the dismissal of the three employees complies with the definition of a contingent liability therefore the claim should be disclosed as a contingent liability.

A contingent liability is:

a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
b) a present obligation that arises from past events but is not recognised because:
   - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   - the amount of the obligation cannot be measured with sufficient reliability.

Please note: No journal entry should be prepared to record a contingent liability. A contingent liability should only be disclosed by way of a note to the annual financial statements. For each class of contingent liability, a brief description of its nature is given, as well as, where practicable:

- an estimate of its financial effect;
- an indication of the uncertainties relating to the amount or timing of any outflow; and
- the possibility of any reimbursement.

SOLUTION QUESTION 2 (continued)

6. **Contingent asset**
   Stoneridge Ltd instituted a claim against Save Security Ltd during the financial year of R50 000 for failing to protect the premises of Stoneridge Ltd. The company's legal advisors are of the opinion that Stoneridge Ltd's claim will probably succeed.



LECTURER'S COMMENT

The claim against Save Security Ltd complies with the definition of a contingent asset therefore the claim should be disclosed as a contingent asset.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Please note: No journal entry should be prepared to record a contingent asset. A contingent asset should only be disclosed, by way of a note to the annual financial statements. Should an inflow of economic benefits be probable, the following disclosure requirements apply to contingent assets:

- a brief description of the nature of the contingent asset;
- an estimate of the financial effect of the contingent asset, measured in accordance with the same principles that apply to provisions and contingent liabilities, provided it is practicable to obtain this information.



SUGGESTED SOLUTION QUESTION 3

a) **Calculation of profit before tax for the financial year ended 28 February 20.11:**

	R
Profit before tax (given)	690 000
Change in estimate depreciation $\frac{(300\,000)}{2} - \frac{(500\,000)}{5}$	(50 000)
Cash on delivery sales – contract liability	(40 000)
Bad debts written off (10 000 x 90%)	(9 000)
Interest – tax 20.10	(4 000)
Penalties – tax 20.10	(6 000)
	581 000

b) **Calculation of current tax due to SA Revenue Service for the financial year ended 28 February 20.11:**

	R
Profit before tax (from (a))	581 000
Exempt differences	(50 800)
Dividends received	(60 000)
Interest on tax	4 000
Penalties on late submission of tax return	6 000
Capital profit on sale of machine (24 000 - 20 000) x (100% - 80%)	(800)
Profit after exempt differences	530 200
Temporary differences	87 000
Depreciation	150 000
Tax allowance - machinery (500 000 /4)	(125 000)
Cash on delivery sales – contract liability	40 000
Royalties received in advance – contract liability	20 000
Recoupment on sale of machine (20 000 - 10 000)	10 000
Profit on sale of machine (20 000 - 12 000)	(8 000)
Taxable income	617 200
Current tax (617 200 x 28%)	172 816
Provisional tax paid (50 000 + 70 000)	(120 000)
	52 816



HOW SHOULD I RECORD THE CURRENT TAX EXPENSE AND THE PROVISIONAL TAX PAYMENTS?

The following journal entries should be prepared for the year ended 28 February 20.11:

	Dr	Cr
31 August 20.10	**R**	**R**
SA Revenue Service / Current tax payable (SFP)	50 000	
Bank (SFP)		50 000
Recording the first provisional tax payment for the year		
28 February 20.11		
Current tax expense (P/L)	172 816	
SA Revenue Service / Current tax payable (SFP)		172 816
Recording current tax expense for the current year		
SA Revenue Service / Current tax payable (SFP)	70 000	
Bank (SFP)		70 000
Recording the second provisional tax payment for the year		

SOLUTION QUESTION 3 (continued)

EXPLANATION: CAPITAL GAIN, PROFIT ON SALE AND RECOUPMENT ON SALE
If the selling price (SP) (proceeds on sale) is higher than the original cost price (CP) of the asset sold, then: • the difference between the SP and the CP is a capital profit, of which 80% is taxable in the case of companies and which results in an exempt difference for deferred tax purposes; • the difference between the CP and the carrying amount (CA) is a profit on sale which results in a temporary difference for deferred tax purposes. Profit before tax should be adjusted as follows to calculate taxable income: • the 20% of the capital profit which is not taxable should be deducted from profit before tax, therefore the 80% is included in taxable income; • the accounting profit (CP – CA) should be deducted from profit before tax and the recoupment of tax allowances (CP – tax base) should be added to profit before tax, therefore excluding accounting profit from taxable income and including recoupment in taxable income.

c) **Calculation of the deferred tax balance in the statement of financial position of Rainbow Ltd for the financial year ended 28 February 20.11:**

	Carrying amount R	**Tax base R**	**Temporary difference R**	**Deferred tax asset/(liability) @ 28% R**
Contract liability - royalties received in advance	20 000	-	20 000	5 600
Machinery	150 000[1]	125 000[2]	25 000	(7 000)
Contract liability - Cash on delivery sales	40 000	-	40 000	11 200
Deferred tax asset				9 800

[1] 300 000 – 150 000
[2] 250 000 – (500 000 x 25%)

EXPLANATION: CONTRACT LIABILITY
• The tax base (TB) of the **contract liability – royalties received in advance** – is its carrying amount (CA) less any amount of revenue that will not be taxable in future (20 000 – 20 000). The amount of royalties received in advance is included in the calculation of taxable income for the financial year ended 28 February 20.11 (refer (b) above). The amount is taxable in the current year and therefore will not be taxable is future. • The tax base (TB) of the **contract liability – cash received in advance on cash on delivery sales** – is its carrying amount (CA) less any amount of revenue that will not be taxable in future (40 000 – 40 000). The amount of cash received in advance is included in the calculation of taxable income for the financial year ended 28 February 20.11 (refer (b) above). The amount is taxable in the current year and therefore will not be taxable is future. **Rule 4: CA of the liability > TB of the liability = DEFERRED TAX ASSET (SFP)**

SOLUTION QUESTION 3 (continued)



HOW SHOULD I RECORD THE DEFERRED TAX MOVEMENT?

The following journal entry should be prepared to record the deferred tax movement for the year ended 28 February 20.11 (the general ledger account is shown below):

	Dr R	Cr R
Deferred tax asset (SFP)	24 880	
Deferred tax expense (P/L) (9 800 + 15 080)		24 880
Recording deferred tax movement for the current year		

Dr	Deferred tax (SFP)			Cr
		01/03/20.10 Opening balance	b/d	15 080
28/02/20.11 Deferred tax expense (P/L)	24 880	28/02/20.11 Closing balance	c/d	9 800
	24 880			24 880
01/03/20.11 Opening balance b/d	9 800			

Dr	Deferred tax expense (P/L)	Cr
	28/02/20.11 Deferred tax (SFP)	24 880



LECTURER'S COMMENT

Remember that the opening credit balance of the deferred tax account amounted to R15 080 and that the closing debit balance of the deferred tax account amounted to R9 800. The journal records the **movement** between the opening and closing balances of the deferred tax account in the accounting records of Rainbow Ltd.

	R
Closing deferred tax balance (asset)	9 800
Opening deferred tax balance (liability)	(15 080)
Movement (15 080 + 9 800) (Debit to deferred tax asset (SFP))	24 880

d) **Tax rate reconciliation**

	R
Standard tax rate (581 000 x 28%)	162 680
Adjusted for exempt differences	
Dividends received (60 000 x 28%)	(16 800)
Change in tax rate (15 080 x 1/29)	(520)
Interest on tax (4 000 x 28%)	1 120
Penalties (6 000 x 28%)	1 680
Capital profit on sale of machine (800 x 28%)	(224)
Overprovision 20.10 (20 000 – (15 000 – 4 000 – 6 000))	(15 000)
	132 936



LECTURER'S COMMENT

The income tax expense in the statement of profit or loss and other comprehensive income should have been R162 680 (581 000 x 28%). The income tax expense is currently shown as R132 936. The reason for the difference is that exempt differences have no tax consequences, the prior year current tax was overprovided for and the tax rate changed. IAS 12 requires a reconciliation of the relationship between the tax expense and the profit before tax (accounting profit).

SOLUTION QUESTION 3 (continued)

e) **RAINBOW LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.11
Profit before tax
Included in depreciation for 20.11 is a change in estimate resulting in an increase in depreciation in machinery for the current year of R50 000 (150 000 – 100 000) that arose from the decision to change the remaining useful life of machinery in the current year to two years as the machinery are already used to full capacity. This change will result in a decrease of depreciation in future periods of R50 000.



LECTURER'S COMMENT

Only the depreciation for the current year, i.e. 28 February 20.11, should reflect the **newest** estimate. The change in estimate should be applied prospectively as follows:

- Start with the carrying amount of the asset at the beginning of the current year
- Apply the newest estimate to it.

The newest estimate can relate to:

- depreciation method;
- useful life;
- residual value.



HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING ESTIMATE?

The following journal entry should be prepared to record the change in accounting estimate for the current year:

	Dr	Cr
28 February 20.11	**R**	**R**
Depreciation (P/L)	50 000	
Accumulated depreciation - Machinery (SFP)		50 000
Recording the change in depreciation due to the change in remaining useful life		



SUGGESTED SOLUTION QUESTION 4

a) **Discussion in terms of the Conceptual Framework for Financial Reporting 2010**

In order to recognise the provision for refunds as a liability both the definition of a liability as well as the recognition criteria of a liability must be met in terms of the Conceptual Framework for Financial Reporting 2010.

In terms of the liability definition:

- There must be a present obligation,
- As a result of a past event, and
- The settlement of which is expected to result in an outflow of future economic benefits (par.4.25(b))

In terms of the recognition criteria a liability which meets the definition of a liability may only be recognised as a liability in the financial statements if:

- It is probable that future economic benefits will flow from the entity, and
- The element has a cost or value that can be measured reliably (par 4.49)

Discussion:
The provision for refunds meets the definition of a liability:

- The past event is the selling of electric shavers during the current year to customers by Bemington Ltd.
- There is a present obligation as the guarantee of refunds is advertised in the package insert and it is generally known.
- The settlement of the obligation will result in outflow of cash (refunds) when customers return the electric shavers to Bemington Ltd.

The provision for refunds meets the recognition criteria:

- The value can be measured reliably as it is based on past sales and refund history of Bemington Ltd.
- The outflow of future economic benefits is probable.

Conclusion: Since both the definition and the recognition criteria have been met, the provision for refunds should be treated as a liability in the financial statements.



HOW SHOULD I APPROACH THIS QUESTION ON THE CONCEPTUAL FRAMEWORK?

First, state the definition and recognition criteria of a liability. You should know the definitions and recognition criteria of all the elements of the financial statements.

After stating the definition and recognition criteria, consider whether the item complies with the definition of a liability and then test the item against the recognition criteria.

Finally, conclude whether the item should be recognised as a liability.

SOLUTION QUESTION 4 (continued)

b) **BEMINGTON LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 2011

1. **Provisions for refunds**

	2011 R	2010 R
Carrying amount beginning of year	25 000	-
Amount used during the year	(9 000)	-
Unused amount reversed during the year/(transferred to income) (25 000 – 9 000)	(16 000)	-
Provision made during the year	40 000	25 000
Carrying amount end of year	40 000	25 000

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



LECTURER'S COMMENT

In terms of IAS 37.14, a provision is only recognised when:
- the entity has a present **legal** or **constructive** obligation to forfeit economic benefits as a result of events in the past ("whether it complies")
- it is **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation ("when"); and
- a **reliable estimate** of the obligation can be made ("how much").

2. **Contingent liability**
A claim of R100 000 was received during the year for animal abuse from Blue Cross Ltd. The company's legal advisor is of the opinion that it is probable that the company will not be found liable for the claim.



LECTURER'S COMMENT

The claim received for animal abuse from Blue Cross Ltd complies with the definition of a contingent liability therefore the claim should be disclosed as a contingent liability.

A contingent liability is:
a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
b) a present obligation that arises from past events but is not recognised because:
   - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   - the amount of the obligation cannot be measured with sufficient reliability.

Please note: No journal entry should be prepared to record a contingent liability. A contingent liability should only be disclosed by way of a note to the annual financial statements. For each class of contingent liability, a brief description of its nature is given, as well as, where practicable:

- an estimate of its financial effect;
- an indication of the uncertainties relating to the amount or timing of any outflow; and
- the possibility of any reimbursement.

SOLUTION QUESTION 4 (continued)

3. **Contingent asset**
   Bemington Ltd sells its electric shavers, with a guarantee against manufacturing defects by the supplier/manufacturer of the electric shavers. It is probable but not virtually certain that R24 000 (60% x 40 000) of the electric shavers sold will be reimbursed by the manufacturer.



LECTURER'S COMMENT

The guarantee against manufacturing defects by the supplier/manufacturer of the electric shavers complies with the definition of a contingent asset therefore the guarantee should be disclosed as a contingent asset.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Please note: No journal entry should be prepared to record a contingent asset. A contingent asset should only be disclosed, by way of a note to the annual financial statements. Should an inflow of economic benefits be probable, the following disclosure requirements apply to contingent assets:

- a brief description of the nature of the contingent asset;
- an estimate of the financial effect of the contingent asset, measured in accordance with the same principles that apply to provisions and contingent liabilities, provided it is practicable to obtain this information.

c) **BEMINGTON LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 2011

1. **Events after the reporting period**
   During the first week of April 2011, finished goods with a cost of R60 000 at the Isipingo retail outlet were damaged due to a water pipe that burst.



LECTURER'S COMMENT

Non-adjusting events after the reporting period are those events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue that are indicative of conditions that arose after the reporting period.

Amounts recognised in the financial statements should not be adjusted to reflect non-adjusting events after the reporting period, however if the effect of the non-adjusting event is material both the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made should be disclosed.

2. **Error in respect of the prior year**
   Correction of error relating to the discovery of finished goods located at the Isipingo retail outlet not included in finished inventories at year end since 2009. The opening balance of retained earnings at the beginning of 2010 was adjusted while the comparative amounts were restated accordingly. The effect of the adjustment of this error is as follows:

	2010	**1/3/2009**
	R	**R**
Increase in cost of sales (115 000 – 20 000)	(95 000)	-
Decrease in taxation expense (95 000 x 28%)	26 600	-
Decrease in profit	(68 400)	-

SOLUTION QUESTION 4 (continued)

	2010 R	1/3/2009 R
Increase in inventory	20 000	115 000
Increase in current taxation due/ SA Revenue Service (20 000 x 28%); (115 000 x 28%)	(5 600)	(32 200)
Increase in equity	14 400	82 800
Adjustment to retained earnings at the beginning of 2010 (115 000 – (115 000 x 28%))		82 800



HOW SHOULD I RECORD THE ERROR?

The error occurred since the 2009 year end therefore the error is retrospectively corrected by adjusting the comparative amounts for the prior period(s) (2010) in which the error occurred and by restating the opening balances of assets, liabilities and equity for the earliest prior period (1/3/2009) presented**.** The following journal entries should be prepared to correct the error:

1 March 2009	Dr R	Cr R
Inventories (SFP)	115 000	
Current tax payable / SA Revenue Service (SFP)		32 200
Retained earnings (Equity)		82 800
Correction of inventories not included in finished inventories at year end.		
28 February 2010		
Cost of sales (P/L)	95 000	
Inventories (SFP)		95 000
Correction of inventories not included in finished inventories in 2010		
Current tax payable / SA Revenue Service (SFP)	26 600	
Current tax expense (P/L)		26 600
Tax effect of correction of error in 2010		

3. **Change in accounting policy**

The company changed its current inventory valuation method from the weighted average method to the first-in, first-out method in order to improve the matching of income and expenses. It is not possible to account for this change retrospectively as the value of inventories cannot be determined on the first-in, first-out method on 28 February 2010 due to a malfunction in the computer program.

Consequently the change has been accounted for prospectively, without any adjustment against the opening balance of retained earnings. The effect of the change in policy on the results for 2011 is as follows:

	2011 R
Decrease in cost of sales (578 000 + 120 000 – (526 000 + 110 000)	62 000
Increase in income tax expense (62 000 x 28%)	(17 360)
Increase in profit for the year	44 640
Increase in inventory	62 000
Increase in current tax liability/SA Revenue Service (62 000 x 28%)	(17 360)
Increase in equity	44 640

SOLUTION QUESTION 4 (continued)



HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING POLICY?

Neither the cumulative nor the period-specific effect is available for comparative periods therefore the change in accounting policy will be applied prospectively. **Prospective application requires a new accounting policy to be applied from the date on which the policy is changed.** The following journal entries should be prepared to record the change in accounting policy:

28 February 2011	**Dr R**	**Cr R**
Inventories (SFP)	62 000	
Cost of sales (P/L)		62 000
Record the period specific effect of the change in accounting policy for 2011		
Current tax expense (P/L)	17 360	
Current tax payable / SA Revenue Service (SFP)		17 360
Tax effect for the period specific effect of the change in accounting policy for 2011		

d) **Journal entries for the financial year ended 28 February 2011**

		Debit R	**Credit R**
(i)	Revenue (P/L) (800 000 x (100% – 40%)	480 000	
	Accounts receivable (SFP)		480 000
	Recording correction to consignment sales incorrectly recognised		
(ii)	Cost of Sales (P/L) (800 000 x 40% x 100/125)	256 000	
	Inventory (SFP)		256 000
	Recording cost of sales on consignment inventory sold		
(iii)	Revenue (P/L)	50 000	
	Contract liability (SFP)		50 000
	Recording incorrect recognition of revenue reversed for gift vouchers not redeemed		

e) **Calculation of deferred tax balance of Bemington Ltd in the statement of financial position for the year ended 28 February 2011.**

2011	**Carrying amount R**	**Tax base R**	**Temporary difference R**	**Deferred tax asset/ (liability) @ 28% R**
Provision for claims	40 000	-	40 000	11 200
Contract liability	50 000	-	50 000	14 000
Deferred tax asset				25 200

EXPLANATION: PROVISION AND CONTRACT LIABILITY

- The tax base (TB) of the **provision for claims** is equal to the carrying amount (CA) less the amount deductible for tax purposes in future (40 000 – 40 000)). The TB represents two amounts, namely the liability for claims of R40 000 and the tax allowance of R40 000 still due as a deduction from tax in the future.
- The tax base (TB) of the **contract liability – gift vouchers** – is its carrying amount (CA) less any amount of revenue that will not be taxable in future (50 000 – 50 000). The amount of gift vouchers not redeemed is included in the calculation of taxable income for the current financial year. The amount is taxable in the current year and therefore will not be taxable is future.

Rule 4: CA of the liability > TB of the liability = DEFERRED TAX ASSET (SFP)



SUGGESTED SOLUTION QUESTION 5

a) **Correcting journal entry**

	Debit R	Credit R
Revenue (calculation 1) (P/L)	5 315	
Contract liability (SFP)		5 315
Recording of correction in revenue recognition		

Calculation 1	**Stand-alone selling prices R**	**Allocation percentage**	**Allocated transaction price R**
Biscuits (180 000 x $^{124}/_{100}$)	223 200	97,638%	219 685
Award credits ((225 000 / 50) x 1.2)	5 400	2,362%	5 315
	228 600		225 000



LECTURER'S COMMENT

Customer options to acquire additional goods or services for free or at a discount may come in the form of customer award credits (or points).

The customer award credits (or points) are accounted for as a performance obligation in the contract only if it provides a material right to the customer. If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

The transaction price is allocated to performance obligations on a relative stand-alone selling price basis.

b) **Calculation of correct profit before tax for the year ended 31 December 2011**

	R
Profit before tax	1 250 000
Customer loyalty programme	(5 315)
Consignment sales (56 000 x $^{130}/_{100}$)	72 800
Consignment cost of sales (70 000 x 80%)	(56 000)
Change in accounting policy – accounting (38 000 – 25 000)	13 000
Additional costs not provided for – Provision for manufacturing defects	(20 000)
Fines – provisional tax	(5 500)
Adjusted profit before tax	1 248 985

c) **Calculation of current tax expense for the year ended 31 December 2011**

	R
Adjusted profit before tax	1 248 985
Exempt differences:	(44 500)
Fines – provisional tax	5 500
Foreign income	(50 000)
Profit after exempt differences	1 204 485

SOLUTION QUESTION 5 (continued)

	R
Profit after exempt differences (continued)	1 204 485
Temporary difference:	(47 685)
Customer loyalty programme	5 315
Depreciation – old oven (72 000 – 60 000)	12 000
Depreciation – new oven (240 000 – 208 000)	32 000
Tax allowance – old oven (120 000/4 x 6/12)	(15 000)
Tax allowance – new oven (240 000/4 x 8/12)	(40 000)
Accounting loss on sale of oven	50 000
Scrapping allowance on sale of oven (50 000 – 60 000) – (60 000 – 15 000)	(35 000)
Additional costs not provided for – Provision for manufacturing defects	20 000
Actual manufacturing defect costs incurred (given)	(102 000)
Change in accounting policy – accounting (38 000 – 25 000)	(13 000)
Change in accounting policy – tax	38 000
Taxable income	1 156 800
Current tax @ 28% (R1 156 800 x 28%)	323 904
Provisional tax payments (120 000 + 110 000)	(230 000)
Amount due to SA Revenue Service	93 904



HOW SHOULD I RECORD THE CURRENT TAX EXPENSE AND THE PROVISIONAL TAX PAYMENTS?

The following journal entries should be prepared for the year ended 31 December 2011:

	Dr	Cr
30 August 2011	**R**	**R**
SA Revenue Service / Current tax payable (SFP)	120 000	
Bank (SFP)		120 000
Recording the first provisional tax payment for the year		
31 December 2011		
Current tax expense (P/L)	323 904	
SA Revenue Service / Current tax payable (SFP)		323 904
Recording current tax expense for the current year		
SA Revenue Service / Current tax payable (SFP)	110 000	
Bank (SFP)		110 000
Recording the second provisional tax payment for the year		

d) **Calculation of deferred tax balance**

	Carrying amount	Tax base	Temporary difference	Deferred tax asset/ (liability) @ 28%
2010	**R**	**R**	**R**	**R**
Inventory	445 000	420 000	25 000	(7 000)
Provision for manufacturing defects	82 000[1]	-	82 000	22 960
Oven (old)	72 000	60 000	12 000	(3 360)
Deferred tax asset				12 600
2011				
Oven (new)	208 000	200 000[2]	8 000	(2 240)
Contract liability	5 315	-	5 315	1 488
Deferred tax liability				(752)

[1](110 000 – 28 000)

[2] (240 000 – 40 000)

SOLUTION QUESTION 5 (continued)



HOW SHOULD I RECORD THE DEFERRED TAX MOVEMENT?

The following journal entry should be prepared to record the deferred tax movement for the year ended 31 December 2011 (the general ledger account is shown below):

	Dr R	Cr R
Deferred tax expense (P/L)	13 352	
Deferred tax liability (SFP) (752 + 12 600)		13 352
Recording deferred tax movement for the current year		

Dr			Deferred tax (SFP)				Cr
01/01/2011	Opening balance	b/d	12 600	31/12/2011	Deferred tax expense (P/L)		13 352
31/12/2011	Closing balance	c/d	752				
			13 352				13 352
				01/01/2012	Opening balance	b/d	752

Dr		Deferred tax expense (P/L)		Cr
31/12/2011	Deferred tax (SFP)	13 352		



LECTURER'S COMMENT

Remember that the opening debit balance of the deferred tax account amounted to R12 600 and that the closing credit balance amounted to R752. The journal records the **movement** between the opening and closing balances of the deferred tax account in the accounting records of PastryCook Ltd.

	R
Closing deferred tax balance (liability)	(752)
Opening deferred tax balance (asset)	12 600
Movement (12 600 + 752) (Credit to deferred tax liability (SFP))	(13 352)

EXPLANATION: INVENTORY, PROVISION AND CONTRACT LIABILITY

- **Inventory** is not included in the calculation of the deferred tax balance on 31 December 2011 as the SA Revenue Service indicated that they will accept the new inventory valuation method from the current year. At 31 December 2010 the carrying amount of inventory is based on the first-in, first-out method and the tax base of inventory is based on the weighted average method and therefore there is a temporary difference for deferred tax purposes. At 31 December 2011 both the carrying amount and the tax base of inventory are based on the first-in, first-out method of inventory valuation and therefore there is no temporary difference for deferred tax purposes.

  Rule 1: CA of the asset > TB of the asset = DEFERRED TAX LIABILITY (SFP)

- The tax base (TB) of the **provision for manufacturing defects** is equal to the carrying amount (CA) less the amount deductible for tax purposes in future (82 000 – 82 000)). The TB represents two amounts, namely the liability for manufacturing defects of R82 000 and the tax allowance of R82 000 still due as a deduction from tax in the future.

  Rule 4: CA of the liability > TB of the liability = DEFERRED TAX ASSET (SFP)

SOLUTION QUESTION 5 (continued)

EXPLANATION: INVENTORY, PROVISION AND CONTRACT LIABILITY (continued)
• The tax base (TB) of the **contract liability – loyalty credits** – is its carrying amount (CA) less any amount of revenue that will not be taxable in future (5 315 – 5 315). The amount of loyalty credits not redeemed is included in the calculation of taxable income for the current financial year (refer (c) above). The amount is taxable in the current year and therefore will not be taxable is future. **Rule 4: CA of the liability > TB of the liability = DEFERRED TAX ASSET (SFP)**

e) **Tax rate reconciliation**

	R
Standard rate of tax (1 248 985 x 28%)	349 716
Adjusted for exempt differences:	
Foreign income (50 000 x 28%) – 6 500	(7 500)
Fines (5 500 x 28%)	1 540
Underprovision of tax – prior year	8 000
Effective rate of tax	351 756



LECTURER'S COMMENT

The income tax expense in the statement of profit or loss and other comprehensive income should have been R349 716 (1 248 985 x 28%). The income tax expense is currently shown as R351 756. The reason for the difference is that there are no tax consequences for exempt differences, and current tax was underprovided in the prior year. IAS 12 requires a reconciliation of the relationship between the tax expense and the profit before tax (accounting profit).

f) **PASTRYCOOK LTD**
NOTES FOR THE YEAR ENDED 31 DECEMBER 2011

1. **Change in accounting policy**

During the year the company changed its accounting policy in respect of the valuation of inventory from the weighted average method to the first-in, first-out method. This change was necessary as the directors are of the opinion that this will result in a fair presentation of the financial position and operating results because of fluctuations in inventory prices. The change in policy was accounted for retrospectively and comparative amounts have been appropriately restated. The effect of this change is as follows:

	2011 R	2010 R	1/01/2010 R
Decrease in cost of sales (38 000 – 25 000); (25 000 – 9 000)	13 000	16 000	-
Increase in current tax expense (13 000 x 28%); (16 000 x 28%)	(3 640)	(4 480)	-
Increase in profit	9 360	11 520	-
Increase in inventory	38 000	25 000	9 000
Increase in current tax liability/SA Revenue Service (38 000 x 28%)	(10 640)	-	-
Increase in deferred tax liability (25 000 x 28%); (9 000 x 28%)	-	(7 000)	(2 520)
Increase in equity	27 360	18 000	6 480
Adjustment to retained earnings at the beginning of 2010 (9 000 - (9 000 x 28%))			6 480

SOLUTION QUESTION 5 (continued)

	LECTURER'S COMMENT

For prior periods the carrying amount of inventory is based on the first-in, first-out method and the tax base of inventory is based on the weighted average method, resulting in temporary differences for deferred tax purposes. Therefore the deferred tax line item in the statement of financial position and the statement of profit or loss and other comprehensive income are restated for the comparative periods.

However, in the current period both the carrying amount and the tax base of inventory are based on the first-in, first-out method of inventory valuation and therefore there is no temporary difference for deferred tax purposes.

2. **Provision for manufacturing defects**

	2011	**2010**
	R	**R**
Carrying amount beginning of the year	82 000	-
Provision created for the year	-	110 000
Amount used during the year	(82 000)	(28 000)
Carrying amount – end of year	-	82 000

A manufacturing defect was discovered during November 2010 in a specific range of biscuit machines manufactured. The manufacturing defect was repaired for customers free of charge. At year end it is expected that no further costs will be incurred to repair these biscuit machines in the next financial year.

	LECTURER'S COMMENT

In terms of IAS 37.14, a provision is only recognised when:

- the entity has a present **legal** or **constructive** obligation to forfeit economic benefits as a result of events in the past ("whether it complies")
- it is **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation ("when"); and
- a **reliable estimate** of the obligation can be made ("how much").



SUGGESTED SOLUTION QUESTION 6

PART A

a) **Revenue recognition**

The following should be considered in determining revenue from the sale of contracts:

When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (a principal) or to arrange for the other party to provide those goods or services (an agent) (IFRS 15 Appendix B, par. B34).

An entity is an agent if the entity's performance obligation is to arrange for the provision of goods or services by another party. 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). Indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer) include the following:

a) another party is primarily responsible for fulfilling the contract;
b) the entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping or on return;
c) 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;
d) the entity's consideration is in the form of a commission; and
e) 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).

In the scenario relating to the laptops given to clients signing a 3G contract:

a) NCC Cellular is primarily responsible for fulfilling the contract;
b) MallWart Ltd does not have inventory risk before or after the goods have been ordered by a customer, as NCC Cellular provides all the warranties and technical assistance to customers;
c) MallWart Ltd does not have discretion in establishing prices for the other party's goods or services;
d) MallWart Ltd's consideration is in the form of a commission of R500 and a fixed profit of R2 000 (R10 000 – R8 000); and
e) MallWart Ltd is not exposed to credit risk for the amount receivable from a customer as NCC Cellular fully reimburses MallWart Ltd for retail value of the laptop and the commission is payable by NCC Cellular (IFRS 15 Appendix B, par. B37).

Revenue will be recognized when the performance obligation is satisfied. As MallWart Ltd is acting as an agent, the performance obligation is to arrange for the other party to provide those goods or services. MallWart Ltd will therefore satisfy its performance obligation when customers sign for their 3G contracts.

Conclusion:

Revenue from the sale of the 3G contracts can be recognized as all the criteria for revenue from contracts with customers is fulfilled.

SOLUTION QUESTION 6 (continued)

b) **Journals for the year ended 29 February 2012**

	Debit R	Credit R
Accounts receivable (60 x R10 000) (SFP)	600 000	
Revenue (P/L)		600 000
Recording revenue from contracts with customers purchasing Bell Laptops		
Cost of sales (60 x R8 000) (P/L)	480 000	
Inventory (SFP)		480 000
Recording cost of sales for contracts with customers purchasing Bell Laptops		
Accounts receivable (110 x 500) (SFP)	55 000	
Commission income (P/L)		55 000
Recording commission from contracts with customers for 36 month 3G contracts		
Depreciation (P/L)	170 000	
Accumulated depreciation (SFP) (850 000 x 20%)		170 000
Recording depreciation for the current year on the correction of machinery incorrectly classified in the prior year		
Machinery (SFP)	850 000	
Accumulated depreciation (SFP) (850 000 x 20%)		170 000
Retained earnings (SFP)		680 000
Recording correction of prior year error on incorrect classification of machinery		
Provision for warranty claims (SFP)	103 000	
Warranty claims (P/L)		103 000
(4 600 000 x 4%) + (3 300 000 x 3%) + (2 500 000 x 2%) – (4 600 000 x 5%)		
Recording the change in estimate for the warranty provision.		

c) The R850 000 wage clock machines costs should be capitalized if it meets the definition of an asset, as well as the recognition criteria of assets as set in the *Conceptual Framework for Financial Reporting 2010*. If the definition and recognition criteria are not met, the item should be expensed.

The *Conceptual Framework for Financial Reporting 2010* defines an asset as:
- a resource controlled by the enterprise;
- as a result of past events; and
- from which future economic benefits are expected to flow to the enterprise.

According to the *Conceptual Framework for Financial Reporting 2010* an asset is recognized when:
- it is probable that future economic benefits will flow to the enterprise, and
- the asset has a cost or value that can be measured reliably.

The definition and recognition criteria of an asset are met as:
- The wage clock machines are under MallWart Ltd's control as they are on the premises of MallWart Ltd.
- The past event is the purchase of the wage clock machines.
- It is expected that economic benefits will flow to the entity in the form of decreased overtime claims.
- The cost of the wage clock machines can be reliably measured at R850 000.

Conclusion:
Since the wage clock machines meet the definition and recognition criteria of an asset it should be capitalized.

SOLUTION QUESTION 6 (continued)

d) **MALLWART LTD**
NOTES FOR THE YEAR ENDED 29 FEBRUARY 2012

1. **Prior period error**
Correction of error in respect of the new wage clock machines installed and incorrectly expensed rather than being capitalized in the 2011 financial year. The effect of the correction of this error on the results of 2011 is as follows:

	2011 **R**
Decrease in expenses (850 000 – 170 000)	680 000
Increase in tax expense (680 000 x 28%)	(190 400)
Increase in profit	489 600
Increase in property, plant and equipment (850 000 – 170 000)	680 000
Increase in current tax due/SARS	(190 400)
Increase in equity	489 600

2. **Contingent liability**
On 31 January 2012 a claim of R400 000 was instituted against MallWart Ltd by the labour union representing the employees of the company. The claim relates to MallWart Ltd allegedly not adhering to the terms as agreed upon during the takeover of SmallCart Ltd by decreasing employee numbers by more than 10%. The legal advisors of MallWart Ltd are of the opinion that it is not probable that the labour union representing the employees of MallWart Ltd will be successful with their claim against the company.



LECTURER'S COMMENT

The claim instituted by the labour union complies with the definition of a contingent liability therefore the claim should be disclosed as a contingent liability.

A contingent liability is:

a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

b) a present obligation that arises from past events but is not recognised because:
   - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   - the amount of the obligation cannot be measured with sufficient reliability.

Please note: No journal entry should be prepared to record a contingent liability. A contingent liability should only be disclosed by way of a note to the annual financial statements. For each class of contingent liability, a brief description of its nature is given, as well as, where practicable:

- an estimate of its financial effect;
- an indication of the uncertainties relating to the amount or timing of any outflow; and
- the possibility of any reimbursement.

3. **Contingent asset**
On 10 February 2012 a claim of R740 000 was instituted by MallWart Ltd against Flamflung Ltd. The claim relates to defective products sold by FlamFlung Ltd to MallWart Ltd. According to the company's legal advisors it is probable but not virtually certain that the claim will succeed.

SOLUTION QUESTION 6 (continued)



LECTURER'S COMMENT

The claim against Flamflung Ltd complies with the definition of a contingent asset therefore the claim should be disclosed as a contingent asset.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Please note: No journal entry should be prepared to record a contingent asset. A contingent asset should only be disclosed by way of a note to the annual financial statements. Should an inflow of economic benefits be probable, the following disclosure requirements apply to contingent assets:

- a brief description of the nature of the contingent asset;
- an estimate of the financial effect of the contingent asset, measured in accordance with the same principles that apply to provisions and contingent liabilities, provided it is practicable to obtain this information.

PART B

PRAGUE LTD
EXTRACT FROM THE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2012

	Retained earnings R
Balance at 1 April 2011	1 490 000
Changes in equity for 2012	
Total comprehensive income for the year	1 372 000
Dividends paid	(650 000)
Balance at 31 March 2012	2 212 000



HOW SHOULD I RECORD THE DIVIDENDS DECLARED?

The following journal entry should be prepared to record the dividends declared:

	Dr R	**Cr R**
Dividends declared	650 000	
Shareholders for dividends (SFP) (balancing figure)		552 500
SA Revenue Service – dividends tax payable (SFP) (650 000 x 15%)		97 500

NOTES FOR THE YEAR ENDED 31 MARCH 2012

1. **Events after the reporting period**
   The board of directors of the company declared a preference dividend of 10 cents per share for the year ended 31 March 2012 on 15 April 2012. The effect of the dividends declared is that retained earnings are reduced by R10 000 (100 000 X 10c).

SOLUTION QUESTION 6 (continued)

	**LECTURER'S COMMENT**
Non-adjusting events after the reporting period are those events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue that are indicative of conditions that arose after the reporting period. Amounts recognised in the financial statements should not be adjusted to reflect non-adjusting events after the reporting period, however if the effect of the non-adjusting event is material both the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made should be disclosed.	



SUGGESTED SOLUTION QUESTION 7

a) **Conceptual Framework for Financial Reporting 2010 discussion:**

The donation of R110 000 made to the Animal Rights National Conference should be capitalized if it meets the definition of an asset, as well as the recognition criteria of an asset as set out in the *Conceptual Framework for Financial Reporting 2010*. If the definition and the recognition criteria is not met, the item should be expensed.

In terms of the definition of an asset, an asset is:
- A resource controlled by the entity;
- As a result of past events;
- From which future economic benefits are expected to flow to the entity.

In terms of the recognition criteria of an asset, an asset should be recognized if:
- It is probable that any future economic benefit associated with the item will flow to the entity; and
- The item has a cost or value that can be measured reliably.

Discussion:
The definition of an asset is not met:
- Although the public image of the company is improved and the improved image could have indirect benefits, it is difficult to indicate to what extent the company has control over the resource.
- It is also difficult to establish the probability of future economic benefits flowing from this donation.

Conclusion:
Since the donation does not meet the definition of an asset it cannot be capitalized / recognized as an asset.



HOW SHOULD I APPROACH THIS QUESTION ON THE CONCEPTUAL FRAMEWORK?

First, state the definition and recognition criteria of an asset. You should know the definitions and recognition criteria of all the elements of the financial statements.

After stating the definition and recognition criteria, consider whether the item complies with the definition of an asset and then test the item against the recognition criteria.

Finally, conclude whether the item should be recognised as an asset.

b) **Correcting journal entries for the year ended 30 June 2012**

	Debit R	Credit R
Revenue (P/L)	60 000	
Contract liability (SFP)		60 000
Recording correction of revenue recognised for performance obligation before the customer obtained control of the asset.		
Inventory (60 000 x $^{100}/_{120}$) (SFP)	50 000	
Cost of sales (P/L)		50 000
Recording correction of cost of sales recognised for performance obligation before the customer obtained control of the asset.		

SOLUTION QUESTION 7 (continued)

c) **Calculation of correct profit before tax for the year ended 30 June 2012**

	R
Profit before tax (given)	940 000
Contract liability	(60 000)
Cost of sales adjustment	50 000
Inventory write-off	(210 500)
Depreciation – change of estimate [(360 000 – 40 000)/4]	(80 000)
Adjusted profit before tax	639 500

d) **Calculation of current tax due to the SA Revenue Service for the year ended 30 June 2012**

	R
Adjusted profit before tax (calculation c)	639 500
Exempt differences:	(130 000)
Foreign income	(240 000)
Donations	110 000
Profit after exempt differences	509 500
Temporary differences:	33 250
Depreciation	80 000
Tax allowance (500 000 x 20%)	(100 000)
Contract liability	60 000
Allowance for credit losses (acc) – current year	31 000
Allowance for credit losses (acc) – prior year	(40 000)
Allowance for credit losses (tax) – current year (31 000 x 25%)	(7 750)
Allowance for credit losses (tax) – prior year (40 000 x 25%)	10 000
Taxable income	542 750
Current tax @ 28% (542 750 x 28%)	151 970
Provisional tax payments (65 000 + 55 000)	(120 000)
Amount due to the SA Revenue Service	31 970



HOW SHOULD I RECORD THE CURRENT TAX EXPENSE AND THE PROVISIONAL TAX PAYMENTS?

The following journal entries should be prepared for the year ended 30 June 2012:

	Dr	Cr
31 December 2011	**R**	**R**
SA Revenue Service / Current tax payable (SFP)	65 000	
Bank (SFP)		65 000
Recording the first provisional tax payment for the year		
30 June 2012		
Current tax expense (P/L)	151 970	
SA Revenue Service / Current tax payable (SFP)		151 970
Recording current tax expense for the current year		
SA Revenue Service / Current tax payable (SFP)	55 000	
Bank (SFP)		55 000
Recording the second provisional tax payment for the year		

SOLUTION QUESTION 7 (continued)

e) **Calculation of deferred tax balance in the statement of financial position for the year ended 30 June 2012**

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) @ 28% R
Contract liability	60 000	-	60 000	16 800
Manufacturing equipment	240 000[1]	200 000[2]	40 000	(11 200)
Allowance for credit losses	31 000	7 750[3]	23 250	6 510
Deferred tax asset – 30 June 2012				12 110

[1] (360 000 – 40 000) – [(360 000 – 40 000)/4]
[2] (340 000 – 40 000) – (500 000 x 20%)
[3] 31 000 x 25%

f) **4FEED LTD**
NOTES FOR THE YEAR ENDED 30 JUNE 2012

1. **Income tax expense**
Tax rate reconciliation

	R
Standard tax (639 500 x 28%)	179 060
Exempt differences	
Foreign income (240 000 x 28%) – 36 000	(31 200)
Donations paid (110 000 x 28%)	30 800
	178 660



LECTURER'S COMMENT

The income tax expense in the statement of profit or loss and other comprehensive income should have been R179 060 (639 500 x 28%) The income tax expense is currently shown as R178 660. The reason for the difference is that exempt differences have no tax consequences. IAS 12 requires a reconciliation of the relationship between the tax expense and the profit before tax (accounting profit).

g) **4FEED LTD**
NOTES FOR THE YEAR ENDED 30 JUNE 2012

1. **Profit before tax**
Included in depreciation for 2012 is a change in estimate resulting in an increase in depreciation of R16 000 (80 000 – [360 000 – 40 000] x 20%), arising from the decision to depreciate manufacturing equipment on the straight line method over an estimated remaining useful life of 4 years instead of the reducing balance method. This change will result in a decrease of depreciation in future periods of R16 000.

2. **Contingent liability**
During the year Benfontein Horse Racing Club instituted a claim of R500 000 against 4Feed Ltd after a prize winning horse died during a race. At year end, the lawyers of 4Feed Ltd advised the company that it is not probable that the company will be found liable for the claim submitted during the current financial year.

In terms of *IAS 37 – Provisions, contingent liabilities and contingent assets*, the claim received from Mr Kansvat is not required to be disclosed as the possibility of the claim being successful is considered by the legal advisors to be remote. Therefore, no provision should be recognized and no disclosure should be made.

SOLUTION QUESTION 7 (continued)



LECTURER'S COMMENT

The claim instituted after the death of a champion race horse complies with the definition of a contingent liability therefore the claim should be disclosed as a contingent liability.

A contingent liability is:

a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
b) a present obligation that arises from past events but is not recognised because:
   - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   - the amount of the obligation cannot be measured with sufficient reliability.

Please note: No journal entry should be prepared to record a contingent liability. A contingent liability should only be disclosed by way of a note to the annual financial statements. For each class of contingent liability, a brief description of its nature is given, as well as, where practicable:

- an estimate of its financial effect;
- an indication of the uncertainties relating to the amount or timing of any outflow; and
- the possibility of any reimbursement.

3. **Contingent asset**
   The water pipes in the warehouse were damaged during June 2012. The burst water pipes were repaired by 4Feed Ltd at a cost of R17 000. Due to the damage caused by the burst water pipes it is probable but not virtually certain that the landlord will refund 4Feed Ltd for the repair costs incurred.



LECTURER'S COMMENT

The claim against the landlord complies with the definition of a contingent asset therefore the claim should be disclosed as a contingent asset.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Please note: No journal entry should be prepared to record a contingent asset. A contingent asset should only be disclosed by way of a note to the annual financial statements. Should an inflow of economic benefits be probable, the following disclosure requirements apply to contingent assets:

- a brief description of the nature of the contingent asset;
- an estimate of the financial effect of the contingent asset, measured in accordance with the same principles that apply to provisions and contingent liabilities, provided it is practicable to obtain this information.

4. **Error in respect of prior year**
   Correction of repair costs incorrectly accounted for as manufacturing equipment. The effect of the error has been accounted for retrospectively and comparative amounts have been appropriately restated.

	2011 **R**
Increase in expenses	35 088
Decrease in current tax expense (35 088 x 28%)	(9 825)
Decrease in profit	25 263

SOLUTION QUESTION 7 (continued)

	2011 R
Decrease in manufacturing equipment account	40 000
Increase in VAT input account	(4 912)
	35 088
Decrease in current tax liability / SA Revenue Service (35 088 x 28%)	(9 825)
Decrease in equity	25 263



HOW SHOULD I RECORD THE ERROR?

The error occurred in the prior year therefore the comparative amounts are restated**.** The following journal entries should be prepared to correct the error:

30 June 2011	**Dr R**	**Cr R**
Repairs (P/L)	35 088	
VAT input account (SFP)	4 912	
Manufacturing equipment (SFP)		40 000
Correction of repair costs incorrectly recognised as manufacturing equipment		
Current tax payable / SA Revenue Service (SFP)	9 825	
Current tax expense (P/L)		9 825
Tax effect of correction of error in 2011		



SUGGESTED SOLUTION QUESTION 8

PART A

a) **Additional and correcting journals for the years ended 28 February 2011 and 29 February 2012**

	Debit	Credit
28 February 2011	**R**	**R**
Provision for data recovery costs (SFP)	357 000	
Bank (SFP) (230 000 + 127 000)		357 000
Recording payments made to the data recovery specialist for the year ended 28 February 2011		
1 March 2011		
Offsite backup costs (P/L)	400 000	
Bank (SFP)		400 000
Recording payment of annual off-site backup storage fees		
29 February 2012		
Provision for data recovery costs (SFP) (685 000 - 357 000)	328 000	
Bank (SFP)		305 000
Data recovery costs (P/L) (685 000 – 357 000 – 305 000)		23 000
Recording final payment made to the data recovery specialist and reversing the unused provision balance.		
Service fees received (P/L) (50 000 x 2%)	1 000	
Allowance account for settlement discounts (SFP)		1 000
Recording of correction of the transaction price to the expected amount of consideration		
Licencing fees paid in advance (SFP)	55 000	
Licensing fees (P/L) (60 000 – (60 000/2 x 2/12))		55 000
Recording the correction of licence fees paid in advance for 22 months		

b) **DATACAPS LTD**
NOTES FOR THE YEAR ENDED 29 FEBRUARY 2012

1. **Provision for data recovery costs**

	2012	2011
	R	**R**
Carrying amount beginning of the year	328 000	-
Provision created for the year	-	685 000
Amount used during the year (230 000 + 127 000)	(305 000)	(357 000)
Unused provision reversed during the year (328 000 – 305 000)	(23 000)	-
Carrying amount – end of year	-	328 000

On 31 October 2010 Datacaps Ltd's computer data warehouse was completely destroyed as a result of a fire which resulted in the loss of all the financial data of a leading bank. Datacaps Ltd undertook to recover the data at no additional cost to the client. At year end it is expected that no further costs will be incurred to recover the data of the client in the next financial year.

SOLUTION QUESTION 8 (continued)

2. **Change in accounting policy**
During the year the company changed its accounting policy in respect of the valuation of inventory from the weighted average method to the first-in, first-out method in order to improve the matching of revenue and expenses to ensure a more fair presentation of the financial position of the company. It is not possible to fully account for this change retrospectively, as the value of inventories cannot be determined on the first-in, first-out method on 28 February 2010, with the result that the effect of the change on the profit for 2011 cannot be determined. Consequently the change has been accounted for retrospectively from the beginning of the 2012 financial year. The effect of the change is as follows:

	2012 R	2011 R
Decrease in cost of sales (120 000 – 20 000)	100 000	-
Increase in income tax expense (100 000 x 28%)	(28 000)	-
Increase in profit	72 000	-
Increase in inventory	120 000	20 000
Increase in current tax liability / SA Revenue Service (120 000 x 28%)	(33 600)	-
Increase in deferred tax liability (20 000 x 28%)	-	(5 600)
Increase in equity	86 400	14 400
Adjustment to retained earnings at the beginning of 2012		14 400



LECTURER'S COMMENT

For the prior period the carrying amount of inventory is based on the first-in, first-out method and the tax base of inventory is based on the weighted average method, resulting in temporary differences for deferred tax purposes. Therefore the deferred tax line item in the statement of financial position and the statement of profit or loss and other comprehensive income are restated for the comparative period.

However, in the current period both the carrying amount and the tax base of inventory are based on the first-in, first-out method of inventory valuation and therefore there is no temporary difference for deferred tax purposes.

3. **Events after the reporting period – ASBA Bank**
During March 2012 ASBA Bank Ltd announced that it downgraded all IT. companies' credit ratings. The announcement resulted in a significant decline in Datacaps Ltd share price from R2,00 per share to 50 cents per share. It is furthermore expected that Datacaps Ltd will experience a significant decline in profits due to negative market sentiment towards the IT. industry after the announcement.



LECTURER'S COMMENT

Non-adjusting events after the reporting period are those events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue that are indicative of conditions that arose after the reporting period.

Amounts recognised in the financial statements should not be adjusted to reflect non-adjusting events after the reporting period, however if the effect of the non-adjusting event is material both the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made should be disclosed.

SOLUTION QUESTION 8 (continued)

c) **Calculation of deferred tax balance**

2011	**Carrying amount R**	**Tax base R**	**Temporary difference R**	**Deferred tax asset/ (liability) @ 28% R**
Provision for data recovery costs (685 000 – 230 000 – 127 000)	328 000	-	328 000	91 840
Inventory	195 000	175 000	20 000	(5 600)
Deferred tax asset				86 240
2012				
Expenses prepaid	55 000	-	55 000	(15 400)
Deferred tax liability				(15 400)

PART B

Characteristics of market participants:

Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

(a) they are independent of each other, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms;

(b) they are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary;

(c) they are able to enter into a transaction for the asset or liability; and

(d) they are willing to enter into a transaction for the asset or liability, i.e. they are motivated but not forced or otherwise compelled to do so.



SUGGESTED SOLUTION QUESTION 9

a) **Conceptual Framework for Financial Reporting 2010:**

Expense
In terms of the definition of an expense, expenses are:
- Decreases in economic benefits during the accounting period
- in the form of outflows/depletions of assets or incurrence of liabilities
- that result in decreases in equity, other than those relating to distributions to equity participants. (par. 4.25(b))

Liability
In terms of the definition of a liability, a liability is:
- A present obligation of the entity
- arising from past events,
- the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. (par. 4.4(b))



HOW SHOULD I APPROACH THIS QUESTION ON THE CONCEPTUAL FRAMEWORK?

State the definition of an expense and a liability. You should know the definitions of all the elements of the financial statements.

b) **EPRINT LTD**
NOTES FOR THE YEAR ENDED 31 MARCH 20.13
Income tax expense
Major components of tax expense

	20.13 **R**
Current tax expense – current year (refer 1)	282 712
Deferred tax expense – temporary differences (refer 2)	2 044
Foreign tax	24 000
	308 756

1. **Calculation of current tax expense for the year ended 31 March 20.13:**

	R
Profit before tax (given)	1 144 000
Exempt differences:	(127 015)
Penalty (2 240 / 28%)	8 000
Foreign income [(24 000 + 9 600) / 28%)	(120 000)
Capital profit on sale of machine (4 204 / 28%) or (495 075 - 420 000) x (100% - 80%)	(15 015)
Profit after exempt differences (continued)	1 016 985
Temporary differences:	(7 300)
Depreciation – Gobbler	63 000
Depreciation – Eco Green	29 200
Tax allowance – Gobbler (420 000 / 4)	(105 000)
Tax allowance – Eco Green (584 000 / 4)	(146 000)
Profit on sale of the Gobbler 159 075 – (7 021 / 28% / 33,4%) or 159 075 – (495 075 – 420 000) or 420 000 – [420 000 – 21 000 – 63 000]	(84 000)
Recoupment on sale of the Gobbler (420 000 – [420 000/4 x 2]	210 000
Provision for guarantee (43 500 – 6 500)	37 000
Actual repair costs incurred	(29 500)
Change in accounting policy – accounting	18 000

SOLUTION QUESTION 9 (continued)

Taxable income	1 009 685
Current tax @ 28% (1 009 685 x 28%)	282 712



HOW SHOULD I RECORD THE CURRENT TAX?

The following journal entry should be prepared for the year ended **31 March 20.13**:

31 March 20.13	**Dr R**	**Cr R**
Current tax expense (P/L)	282 712	
SA Revenue Service / Current tax payable (SFP)		282 712
Recording current tax expense for the current year		

EXPLANATION: CAPITAL GAIN, PROFIT ON SALE AND RECOUPMENT ON SALE

If the selling price (SP) (proceeds on sale) is higher than the original cost price (CP) of the asset sold, then:

- the difference between the SP and the CP is a capital profit, of which 80% is taxable in the case of companies and which results in an exempt difference for deferred tax purposes;
- the difference between the CP and the carrying amount (CA) is a profit on sale which results in a temporary difference for deferred tax purposes.

Profit before tax should be adjusted as follows to calculate taxable income:

- the 20% of the capital profit which is not taxable should be deducted from profit before tax, therefore the 80% is included in taxable income;
- the accounting profit (CP – CA) should be deducted from profit before tax and the recoupment of tax allowances (CP – tax base) should be added to profit before tax, therefore excluding accounting profit from taxable income and including recoupment in taxable income

2. **Calculation of deferred tax expense for the year ended 31 March 20.13**

	Carrying amount R	**Tax base R**	**Temporary difference R**	**Deferred tax asset/ (liability) @ 28% R**
Eco Green Machine	554 800[1]	438 000[2]	116 800	(32 704)
Provision for guarantee	43 500	-	43 500	12 180
Inventory	230 000	290 000	60 000	16 800
Deferred tax liability – 31 March 20.13				(3 724)

[1] 584 000 – 29 200 [2] 584 000 – (584 000 / 4)

	R
Deferred tax liability – 31 March 20.13	3 724
Deferred tax liability – 31 March 20.12	(1 680)
Deferred tax movement (debit to the statement of profit or loss and other comprehensive income)	2 044

SOLUTION QUESTION 9 (continued)



LECTURER'S COMMENT

How to approach a question when disclosure of the income tax expenses note is required:

1. Calculate the current tax expense for the year.
2. Calculate the deferred tax balance for the previous year if not given.
3. Calculate the deferred tax balance for the current year.
4. Calculate the deferred tax movement based on calculations (2) and (3) above.
5. Calculate the tax rate change if any.
6. Prepare the first part of the income tax expense note using the information calculated in (1) to (5) above. Prepare the tax rate reconciliation note in Rand or percentages (as required by the question).

c) **EPRINT LTD**
NOTES FOR THE YEAR ENDED 31 MARCH 20.13

1. **Provision for manufacturing defects**

	20.13	**20.12**
	R	**R**
Carrying amount beginning of the year	36 000	-
Provision created for the year	43 500	36 000
Amount used during the year	(29 500)	-
Unused provision reversed during the year	(6 500)	-
Carrying amount end of year	43 500	36 000

During February 20.12 Eprint Ltd implemented a guarantee policy to repair all electronic books with a manufacturing defect at no cost to the customer within 6 months from the date of sale.

2. **Events after the reporting period**
On 15 April 20.13, Eprint Ltd became aware that a material debtor, KidsBooks Ltd, with a balance of R130 130 on 31 March 20.13 is experiencing financial difficulties caused by their warehouse being destroyed in a fire on 9 April 20.13. There is uncertainty if KidsBooks Ltd will settle their debt.



LECTURER'S COMMENT

Non-adjusting events after the reporting period are those events, both favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue that are indicative of conditions that arose after the reporting period.

Amounts recognised in the financial statements should not be adjusted to reflect non-adjusting events after the reporting period, however if the effect of the non-adjusting event is material both the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made should be disclosed.

SOLUTION QUESTION 9 (continued)

d) **EPRINT LTD**
EXTRACT FROM THE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 20.13

	Retained Earnings R
Balance at 1 April 20.11 (1 827 760 + 12 240)	1 840 000
Change in accounting policy	(12 240)
Restated balance	1 827 760
Changes in equity for 20.12	
Total comprehensive income for the year (restated)	650 000
Balance at 31 March 20.12	2 477 760
Changes in equity for 20.13	
Total comprehensive income for the year (1 144 000 – 308 756)	835 244
Balance at 31 March 20.13	3 313 004

e) **EPRINT LTD**
EXTRACT FROM THE STATEMENT OF FINANCIAL POSITION AT 31 MARCH 20.13

	20.13 R	20.12 R	20.11 R
ASSETS			
Current Assets			
Inventory	230 000	103 000	95 000



LECTURER'S COMMENT

Inventory is disclosed in the statement of financial position for the current period (20.13) and each prior period presented (20.12 and 20.11). According to *IAS 1 – Presentation of Financial Statements*, an entity must present a third statement of financial position as at the beginning of the preceding period under the following circumstances:

- The retrospective application of a change in accounting policy
- The retrospective restatement of items in financial statements; or
- The reclassification of items in financial statements.



SUGGESTED SOLUTION QUESTION 10

PART A

a) **Additional requirements for a "bill and hold arrangement"**

In addition to applying the requirements in paragraph 38 of IFRS 15, for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
b) the product must be identified separately as belonging to the customer;
c) the product currently must be ready for physical transfer to the customer; and
d) the entity cannot have the ability to use the product or to direct it to another customer (IFRS 15 Appendix B, par. B81).

b) **Additional and correcting journals for the year ended 28 February 2013**

	Debit R	Credit R
Bank (SFP)	620 730	
Membership fees/revenue (P/L)		620 730
[(5 700 + (5 700 x 10%)) x (85 + 14)] or [(5 700 x 1,1) x (85 +14)]		
Recording revenue from annual membership		
Bank (SFP) (1 330 x 513)	682 290	
Revenue (P/L) (calculation 1)		620 264
Contract liability (SFP) (calculation 1)		62 026
Recording allocated revenue and contract liability based on stand-alone selling prices		
Revenue (P/L)	128 500	
Trade payables (SFP) (48 500 + 80 000)		128 500
Recording of correction of credit notes incorrectly debited to the trades payables account in the current year		
Depreciation (P/L)	117 188	
Accumulated depreciation (SFP)		117 188
[(1 406 250/3) – (1 406 250 – 1 054 688)] or		
[(1 406 250/3) – (1 406 250 x 25%)]		
Recording of change in depreciation due to change in estimate		
Bank (SFP)	400 000	
Revenue (P/L)		400 000
Recording of revenue from contracts with customers		
Cost of sales (P/L)	320 000	
Inventory (SFP) (400 000 x $^{100}/_{125}$)		320 000
Recording of cost of sales from contracts with customers		

Calculation 1	**Stand-alone selling prices R**	**Allocation percentage**	**Allocated transaction price R**
Ten golf games played - paid (513 x 10)	5 130	90,91%	620 264
One free golf game	513	9,09%	62 026
	5 643		682 290[1]

[1] 1330 x R513

SOLUTION QUESTION 10 (continued)

c) **Calculation of deferred tax balance for the year ended 28 February 2013**

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) @ 28% R
Machinery	937 500[1]	1 000 000[2]	62 500	17 500
Contract liability (refer b(2))	62 026	-	62 026	17 367
Deferred tax asset				34 867

1. 1 406 250 – ($^{1\,406\,250}/_{3}$) or (1 054 688 – 117 188)
2. 2 500 000 – (2 500 000 x 20% x 3) or 2 500 000 – ($^{2\,500\,000}/_{5yrs}$ x 3)

d) **NOTES FOR THE YEAR ENDED 28 FEBRUARY 2013**

1. **Profit before tax**

Included in depreciation for 2013 is a change in estimate resulting in an increase in depreciation of R117 188 (refer b(4)), arising from the decision to depreciate tractors on the straight-line method with an estimated remaining useful life of 3 years instead of the reducing balance method. This change will result in a decrease of depreciation in future periods of R117 188.

2. **Error in respect of prior year**

Correction of credit notes incorrectly accounted for as trade payables. The effect of the error has been accounted for retrospectively and comparative amounts have been appropriately restated. The effect of the correction on the results of 2012 is as follows:

	2012 R
Decrease in revenue (190 000 + 260 000)	450 000
Decrease in current tax expense (450 000 x 28%)	(126 000)
Decrease in profit	324 000
Increase in trade payables	450 000
Decrease in current tax liability / SA Revenue Service	(126 000)
Decrease in equity	324 000



HOW SHOULD I RECORD THE ERROR?

The error occurred in the prior year therefore the comparative amounts are restated**.** The following journal entries should be prepared to correct the error:

29 February 2012	Dr R	Cr R
Revenue (P/L)	450 000	
Trade payables (SFP)		450 000
Correction of credit notes incorrectly accounted for as trade payables.		
Current tax payable / SA Revenue Service (SFP)	126 000	
Current tax expense (P/L)		126 000
Tax effect of correction of error in 2012		

SOLUTION QUESTION 10 (continued)

3. **Contingent liability**
   On 12 February 2013 Green Peace instituted a claim of R3 500 000 against Carnastie Ltd for environmental damage caused to a wetland adjacent to Carnastie Links golf course. The damage relates to fertilizer used by Carnastie Links on their greens which possibly polluted the environmentally sensitive wetland. At 28 February 2013 the legal advisor of Carnastie Ltd is of the opinion that it is not probable that the claim will be successful.



LECTURER'S COMMENT

The claim for the environmental damage caused to a wetland adjacent to Carnastie Links golf course complies with the definition of a contingent liability therefore the claim should be disclosed as a contingent liability.

A contingent liability is:

a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
b) a present obligation that arises from past events but is not recognised because:
   - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   - the amount of the obligation cannot be measured with sufficient reliability.

Please note: No journal entry should be prepared to record a contingent liability. A contingent liability should only be disclosed by way of a note to the annual financial statements. For each class of contingent liability, a brief description of its nature is given, as well as, where practicable:

- an estimate of its financial effect;
- an indication of the uncertainties relating to the amount or timing of any outflow; and
- the possibility of any reimbursement..

4. **Contingent asset**
   On 31 January 2013 Carnastie Ltd instituted a claim of R340 000 against Fallaway Golf. The claim relates to a patent infringement by Fallaway Golf with reference to the illegal copying of Bling brand's technology. According to the legal advisor it is probable but not virtually certain that Carnastie Ltd will be successful with their claim.



LECTURER'S COMMENT

The claim against Fallaway Golf complies with the definition of a contingent asset therefore the claim should be disclosed as a contingent asset.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Please note: No journal entry should be prepared to record a contingent asset. A contingent asset should only be disclosed by way of a note to the annual financial statements. Should an inflow of economic benefits be probable, the following disclosure requirements apply to contingent assets:

- a brief description of the nature of the contingent asset;
- an estimate of the financial effect of the contingent asset, measured in accordance with the same principles that apply to provisions and contingent liabilities, provided it is practicable to obtain this information.

SOLUTION QUESTION 10 (continued)

PART B

1. Fair value is defined as:

    - The price
    - that would be received to sell an asset
    - in an orderly transaction
    - between market participants
    - at the measurement date

2. The transaction price might not represent the fair value of an asset at initial recognition if any of the following conditions exist:

    - The transaction is between related parties.
    - The transaction takes place under duress or the seller is forced to accept the price in the transaction.
    - The unit of account represented by the transaction price is different from the unit of account for the asset measured at fair value.
    - The market in which the transaction takes place is different from the principal market (or most advantageous market).



SUGGESTED SOLUTION QUESTION 11

a) **Dividend journal entry**

	Debit	Credit
25 June 20.13	**R**	**R**
Dividends declared (equity) (500 000 x R0,10)	50 000	
Shareholders for dividends (SFP) (balancing figure)		42 500
SA Revenue Service – dividends tax payable (SFP) (50 000 x 15%)		7 500
Recording of dividends declared and dividends tax payable to SA Revenue Service.		

b) **Discussion in terms of the *Conceptual Framework for Financial Reporting 2010***

In terms of the definition of a liability, a liability is:
- A present obligation of the entity,
- Arising from past events,
- The settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (par. 4.4(b)).

In terms of the recognition criteria an element that meets the definition of a liability should be recognised if:
- It is probable that any future economic benefits associated with the item will flow to/from the entity; and
- The item has a cost or value that can be measured reliably (par.4.46).

Discussion:
The dividends declared meet the definition of a liability
- A present obligation exist as the dividends have been declared on 25 June 20.13,
- There is a past event as the event that would lead to the obligation is the declaration of the dividend,
- The settlement will result in an outflow of economic benefits when the dividends are paid on 10 July 20.13.

The dividends declared meet the recognition criteria
- The outflow of future economic benefits is probable as the dividends have been declared and will be paid on 10 July 20.13,
- The value of the dividends can be measured reliably.

Conclusion:
The dividends declared must therefore be treated as a liability as it meets both the definition and recognition criteria.

c) **Correcting journal for the year ended 30 June 20.13**

	Debit	Credit
	R	**R**
Retained earnings (SFP) (81 000 + 54 000)	135 000	
Revenue (P/L)	115 400	
Contract liability (SFP)		250 400
Correction of revenue relating to loyalty programme incorrectly recognized.		

d) **Calculation of profit before tax for the year ended 30 June 20.13**

	R
Profit before tax (given)	1 150 000
Error – loyalty programe	(115 400)
Change in estimate - depreciation [(1 868 800 – 480 000)/2 – (301 760 – 24 000)]	(416 640)
	617 960

SOLUTION QUESTION 11 (continued)

e) **Calculation of current tax expense for the year ended 30 June 20.13**

	R
Profit before tax (from d above)	617 960
Exempt differences:	69 000
Depreciation - Administration building	75 000
Capital gain on spray painting equipment (780 000 – 750 000) x (100% - 80%)	(6 000)
Profit after exempt differences	686 960
Temporary differences:	164 800
Depreciation – Manufacturing equipment	694 400
Depreciation – Spray painting equipment	24 000
Or combined: Depreciation [301 760 + 416 640] = 718 400	
Depreciation – Manufacturing building	100 000
Tax allowance – Manufacturing equipment (including spray painting equipment sold)	(800 000)
Tax allowance – Manufacturing building	(125 000)
Profit on sale of the spray painting equipment (324 000 – 30 000))	(294 000)
Recoupment on sale of the spray painting equipment (750 000 – (450 000 – 150 000))	450 000
Customer loyalty programme	115 400
Taxable income	851 760
Less: Assessed loss	(95 000)
Taxable income	756 760
Current tax @ 28% (756 760 x 28%)	211 893

f) **Calculation of deferred tax balance at 30 June 20.13**

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax asset/ (liability) @ 28% R
Manufacturing building	2 000 000[1]	1 875 000[2]	125 000	(35 000)
Manufacturing equipment	694 400[3]	100 000[4]	594 400	(166 432)
Contract liability	250 400	-	250 400	70 112
Deferred tax liability – 30 June 20.13				(131 320)

[1.] 2 100 000 – 100 000 (given)
[2.] 2 000 000 – 125 000 (given)
[3.] (1 868 800 – 480 000) – 694 400
[4.] (1 200 000 – 450 000) – (800 000 – 150 000)

g) **LAWNERS LTD**
NOTES FOR THE YEAR ENDED 30 JUNE 20.13

1. **Profit before tax**

Included in depreciation for 20.13 is a change in estimate resulting in an increase in depreciation of R416 640 [(1 868 800 – 480 000)/2 – (301 760 - 24 000)], arising from the decision to depreciate equipment on the straight line method with an estimated remaining useful life of 2 years instead of the reducing balance method. This change will result in a decrease of depreciation in future periods of R416 640.

SOLUTION QUESTION 11 (continued)



LECTURER'S COMMENT

Only the depreciation for the current year, i.e. 30 June 20.13, should reflect the **newest** estimate. The change in estimate should be applied prospectively as follows:

- Start with the carrying amount of the asset at the beginning of the current year; and
- apply the newest estimate to it.

The newest estimate can relate to:

- depreciation method;
- useful life;
- residual value.



HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING ESTIMATE?

The following journal entry should be prepared to record the change in accounting estimate for the current year:

	Dr	Cr
30 June 20.13	**R**	**R**
Depreciation (P/L)	416 640	
Accumulated depreciation - Equipment (SFP)		416 640
Recording of depreciation as a result of the change in estimate from the reducing balance method to the straight-line method.		

2. **Error in respect of prior year**
   Correction of revenue incorrectly recorded in the accounting system. Revenue was incorrectly recorded by including revenue attributable to the loyalty award credits immediately on delivery of goods sold. The effect of the error has been accounted for retrospectively and comparative amounts have been appropriately restated. The effect of the correction is as follows:

	20.12	1/7/20.11
	R	R
Decrease in revenue	81 000	-
Decrease in deferred tax expense (81 000 x 28%)	(22 680)	-
Decrease in profit	58 320	-
Increase in contract liability (54 000 + 81 000)	135 000	54 000
Decrease in deferred tax liability (135 000 x 28%); (54 000 x 28%)	(37 800)	(15 120)
Decrease in equity	97 200	38 880

3. **Contingent liability**
   On 21 April 20.13 Lazee Ltd instituted a claim of R850 000 against Lawners Ltd for defective lawnmower tractors sold to Lazee Ltd. On 15 April 20.13 a lawnmower tractor's brakes failed which resulted in the injury of two holidaymakers on the Lazee Ltd holiday resort. At year end on 30 June 20.13 the legal advisors of Lawners Ltd is of the opinion that it is probable that Lawners Ltd will not be found liable for the claim due to insufficient maintenance of its lawnmower tractors by Lazee Ltd.

4. **Contingent asset**
   On 31 May 20.13 Lawners Ltd instituted a legal claim of R250 000 against the newspaper that printed the article "Lawnmower tractor injures holidaymakers". The claim relates to the negative publicity received of Lawners Ltd's products in the article. On 30 June 20.13 the legal advisors of Lawners Ltd are of the opinion that it is probable, but not virtually certain, that Lawners Ltd will be successful with their claim.

SOLUTION QUESTION 11 (continued)

h) **Three most widely used valuation techniques**

Market approach
Cost approach
Income approach

i) A use that is ***physically possible*** takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (e.g. the location or size of a property).

A use that is ***legally permissible*** takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (e.g. the zoning regulations applicable to a property).

A use that is ***financially feasible*** takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment if that asset is put to that use.



SUGGESTED SOLUTION QUESTION 12

a) **Journal entries for the year ended 28 February 2013**

	Debit R	Credit R
Accounts receivable (SFP) [(1 385 x 2 155) - 17 500] x 20%	593 435	
Commission received (P/L)		593 435
Recording of commission revenue received from sales of ZY gearboxes.		
Bank (SFP)	750 000	
Revenue (P/L) (refer calculation 1)		725 175
Contract liability – maintenance revenue (SFP)		24 825
Recording allocated revenue and contract liability based on stand-alone selling prices		
Contract liability – maintenance revenue (SFP)	1 034	
Revenue (P/L) ($\frac{24\,825}{24}$ x 1)		1 034
Recording of revenue received from maintenance plan based on time lapsed		
Cost of sales (P/L)	584 000	
Inventory (SFP) (730 000 x $^{100}/_{125}$)		584 000
Recording of cost of sales of the sports car sold		

Calculation 1	**Stand-alone selling prices**	**Allocation percentage**	**Allocated transaction price**
	R		**R**
Layman sportscar	730 000	96,69%	725 175
Maintenance plan	25 000	3,31%	24 825
	755 000		750 000

b) **Calculation of deferred tax balance in the statement of financial position for the year ended 28 February 2013**

	Carrying amount R	**Tax base R**	**Temporary difference R**	**Deferred tax asset/ (liability) @ 28% R**
Provision for warranty costs (given)	307 000	-	307 000	85 960
Contract liability – maintenance revenue	23 791[1]	-	23 791	6 661
Inventory	683 000	486 000	197 000	(55 160)
Provision for onerous contract	90 000[2]	-	90 000	25 200
Deferred tax asset				62 661

1. (24 825 – 1 034)
2. (6 x 30 000) x 50%

SOLUTION QUESTION 12 (continued)

c) **NOTES FOR THE YEAR ENDED 28 FEBRUARY 2013**

2. **Change in accounting policy**
The company changed its current inventory valuation method from the weighted average method to the first-in, first-out method to ensure that more appropriate estimations of the value of inventory is ascertained. 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:

	2013 R	2012 R	1/3/2011 R
Decrease in cost of sales (829 500 – 787 500); (780 000 – 750 000)	42 000	30 000	-
Increase in deferred tax expense (42 000 x 28%); (30 000 x 28%)	(11 760)	(8 400)	-
Increase in profit	30 240	21 600	-
Increase in inventory (683 000 – 486 000); (510 000 – 355 000); (460 000 – 335 000)	197 000	155 000	125 000
Increase in deferred tax liability (197 000 x 28%); (155 000 x 28%); (125 000 x 28%)	(55 160)	(43 400)	(35 000)
Increase in equity	141 840	111 600	90 000
Adjustment to retained earnings at the beginning of 2012			90 000



LECTURER'S COMMENT

- The SA Revenue Service does not reopen the previous years' tax assessments for the change in accounting policy. Therefore, the tax base of inventory for prior years (2012 and prior) will be determined using the "old" method, i.e. the weighted average method.
- The SA Revenue Service does not accept the current inventory valuation method therefore the tax base of inventory for the current year (2013) will also be determined using the "old" method, i.e. the weighted average method.
- IAS 8 requires that the change in accounting policy be applied retrospectively therefore the carrying amount of inventory for the current year and all prior years will be determined using the "new" method, i.e. the first-in, first-out method.
- Therefore, the carrying amount and tax base of inventory will be different for the current year and all prior years resulting in temporary differences for deferred tax purposes.

3. **Provision for warranty costs**

	2013 R	2012 R
Carrying amount beginning of the year	212 000	-
Provision created for the year (307 000 + 100 911 – 212 000); (212 000 + 30 300)	195 911	242 300
Amount used during the year (given)	(100 911)	(30 300)
Carrying amount – end of year	307 000	212 000

A provision has been made for expected warranty costs on all defective tracking systems sold with a two year mechanical warranty.

SOLUTION QUESTION 12 (continued)

4. **Provision for onerous contract**

	2013 R	2012 R
Carrying amount beginning of the year	-	-
Provision created for the year (refer b)	90 000	-
Carrying amount – end of year	90 000	-

Boxter Ltd made provision for an onerous lease contract relating to a manufacturing plant. The lease expires in 6 months on 31 August 2013.



HOW SHOULD I RECORD THE PROVISION FOR WARRANTY COSTS AND PROVISION FOR ONEROUS CONTRACT?

The following journal entries should be prepared:

	Dr R	Cr R
29 February 2012		
Warranty costs (P/L)	242 300	
Provision for warranty costs (SFP)		242 300
Warranty costs provided for 2012.		
Provision for warranty costs (SFP)	30 300	
Bank (SPF)		30 300
Warranty costs paid during 2012		
28 February 2013		
Warranty costs (P/L)	195 911	
Provision for warranty costs (SFP)		195 911
Warranty costs provided for 2013.		
Provision for warranty costs (SFP)	100 911	
Bank (SPF)		100 911
Warranty costs paid during 2013		
Lease payments – onerous contract (P/L)	90 000	
Provision for onerous contract (SFP)		90 000
Provision made on onerous lease contract payments		

5. **Events after the reporting period**

On 31 March 2013 the eastern side of the manufacturing plant in Cape Town was destroyed in a fire caused by the defective installation of electrical wiring during the relocation. Inventory amounting to R10 997 was damaged. Damage to the manufacturing plant amounted to R490 000[1]. The company's insurance contract does not cover this contingency. A contract was concluded to repair the eastern side of the production facility at a cost of R500 000.

1. R500 997 – R10 997



SUGGESTED SOLUTION QUESTION 13

a) The elements identified are:

- liability; and
- expense

The recognition criteria for these elements are:

- they meet the definition of the relevant element;
- it is probable that future economic benefits will flow from the entity; and
- the item has a cost or value that can be measured with reliability (par. 4.38).

b) **Calculation of correct profit before tax for the year ended 28 February 20.14**

	R
Profit before tax (given)	960 000
Change in estimate – depreciation on delivery vehicles (450 000/2) – 150 000)	(75 000)
Error – depreciation on air conditioners (180 000 x 20%)	(36 000)
	849 000

c) **Calculation of current tax due to SA Revenue Service for the year ended 28 February 20.14**

	R
Profit before tax	849 000
Exempt differences	112 000
Capital profit on sale of machinery (150 000 – 140 000) x (100% - 80%)	(2 000)
Depreciation: Administration building	100 000
Legal fees (15 000 x 60%)	9 000
Fines – Department of Trade and Industry	25 000
Foreign income	(20 000)
Profit after exempt differences	961 000
Temporary differences	87 500
Depreciation (150 000 + 75 000 + 36 000 + 220 000)	481 000
Wear and tear on delivery vehicles (750 000 x 25%) or (375 000 – 187 500)	(187 500)
Wear and tear on machinery (1 100 000 x 25%) or (825 000 – 480 000 – 70 000)	(275 000)
Wear and tear on air conditioners (180 000 x 25%)	(45 000)
Profit on sale of machinery (140 000 – 84 000)	(56 000)
Recoupment on sale of machinery (140 000 – 70 000)	70 000
Prepaid insurance – 20.13 (given)	50 000
Prepaid insurance – 20.14 (given)	(80 000)
Deposit received in advance (given)	40 000
Provision –claim (given)	90 000
Taxable income	1 048 500
Current tax expense (1 048 500 x 28%)	293 580
Less: provisional tax paid (60 000 + 50 000)	(110 000)
Tax due to SA Revenue Service	183 580

SOLUTION QUESTION 13 (continued)

d) **Calculation of deferred tax balance as at 28 February 20.14**

	Carrying amount	Tax base	Temporary differences	Deferred tax asset/ (liability) @ 28%
	R	R	R	R
Delivery vehicles	225 000[1]	187 500	37 500	(10 500)
Machinery	576 000	480 000	96 000	(26 880)
Air conditioners	108 000[2]	90 000[3]	18 000	(5 040)
Insurance prepaid	80 000	-	80 000	(22 400)
Deposit received in advance	40 000	-	40 000	11 200
Provision claim	90 000	-	90 000	25 200
Deferred tax liability				(28 420)

[1] 300 000 – 75 000
[2] 180 000 – (180 000 x 20% x 2)
[3] 180 000 – (180 000 x 25% x 2)

e) **KITCHEN SUPPLY LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.14

Tax rate reconciliation

	R
Standard tax rate (849 000 x 28%)	237 720
Exempt differences	
Legal expenses (9 000 x 28%)	2 520
Fines (25 000 x 28%)	7 000
Capital profit on sale of machinery (2 000 x 28%)	(560)
Foreign income (20 000 x 28%) – 5 000	(600)
Depreciation: Administration building (100 000 x 28%)	28 000
	274 080

f) **KITCHEN SUPPLY LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 20.14

1. **Profit before tax**

Included in depreciation for 20.14 is a change in estimate of R75 000[1] arising from the decision to depreciate vehicles at 25% instead of at 20% per annum according to the straight-line method. This change will result in a decrease of depreciation in future periods of R75 000.

1. (450 000 / 2) – 150 000



LECTURER'S COMMENT

Only the depreciation for the current year, i.e. 28 February 20.14, should reflect the **newest** estimate. The change in estimate should be applied prospectively as follows:

- Start with the carrying amount of the asset at the beginning of the current year; and
- apply the newest estimate to it.

The newest estimate can relate to:

- depreciation method;
- useful life;
- residual value.

SOLUTION QUESTION 13 (continued)



HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING ESTIMATE?

The following journal entry should be prepared to record the change in accounting estimate for the current year:

	Dr	Cr
28 February 20.14	**R**	**R**
Depreciation (P/L)	75 000	
Accumulated depreciation - Equipment (SFP)		75 000
Being recording of change in depreciation to 25% instead of 20% according to the straight-line method.		

2. **Error in respect of prior year**

Correction of error in respect of air conditioners expensed instead of being capitalised in 20.13. The effect of the correction of this error on the results of 20.13 is as follows:

	20.13
	R
Decrease in expenses (180 000 – 36 000)	144 000
Increase in current tax expense (144 000 x 28%)	(40 320)
Increase in profit	103 680
Increase in property, plant and equipment	144 000
Increase in current tax due / SA Revenue Service	(40 320)
Increase in equity	103 680



HOW SHOULD I RECORD THE ERROR?

The error occurred in the prior year therefore the comparative amounts are restated**.** The following journal entries should be prepared to correct the error:

	Dr	Cr
28 February 20.13	**R**	**R**
Air conditioners (SFP)	180 000	
Repairs (P/L)		180 000
Correction of air conditioners incorrectly expensed in 20.13		
Depreciation (P/L)	36 000	
Accumulated depreciation – Air conditioners (SFP)		36 000
Recording of depreciation on air conditioners capitalized in 20.13		
Current tax expense (P/L)	40 320	
SA Revenue Service (SFP)		40 320
Recording of tax effect of correction of error in 20.13		

3. **Contingent liability**

On 15 January 20.14 a client instituted a claim of R50 000 against Kitchen Supply Ltd for kitchen cupboards that he claims were of a sub-standard installation. At year end 28 February 20.14 the legal advisors of Kitchen Supply Ltd are of the opinion that it is not probable that Kitchen Supply Ltd will be found liable for the claim.



SUGGESTED SOLUTION QUESTION 14

a) **Journal entries for transactions (1) to (4) for the year ended 28 February 2014**

	Debit R	Credit R
Repairs (fencing) (P/L)	45 000	
Revenue (P/L)		45 000
Recognising revenue for non-cash consideration received		
Cost of sales (P/L)	43 000	
Inventory (SFP)		43 000
Recognising cost of sales for non-cash revenue transaction		
Bank (SFP)	15 000	
Contract liability (SFP)		15 000
Recording contract liability of consideration received		
Salaries and wages (P/L)	4 800	
Provision for staff bonuses (SFP) (320 000 x 1,5%)		4 800
Recording provision for staff bonuses		
Repair costs (P/L)	260 000	
Provision for repair costs (SFP) (600 000 x 35%) + (1 000 000 x 5%)		260 000
Recording provision for repair costs		
Debtors/ accounts receivable (SFP)	156 000	
Repair costs (P/L) (260 000 x 60%)		156 000
Recording the recoupment from the supplier that is virtually certain		

b) **SQUAD CARS LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 2014

1. **Contingent asset**
Squad Cars Ltd sells battery operated go-carts with a 3-month guarantee. An agreement between Squad Cars Ltd and the supplier of these battery operated go-carts entitles Squad Cars Ltd to recoup 60% of repair cost incurred from the supplier. It is probable but not virtually certain that R156 000 (refer a) of possible repairs incurred will be recouped from the supplier.

c) **SQUAD CARS LTD**
NOTES FOR THE YEAR ENDED 28 FEBRUARY 2014

1. **Change in accounting policy**
The company changed its current inventory valuation method from the last-in, first-out method to the first-in, first-out method in order to comply with *International Financial Reporting Standards (IFRSs)* and to give a more reliable value of the inventory on hand. The change in accounting policy was accounted for retrospectively. The effect of the change in accounting policy is as follows:

SOLUTION QUESTION 14 (continued)

	2014 R	2013 R	1/3/2012 R
Increase in cost of sales (8 000 – 6 000);(11 000 – 8 000)	2 000	3 000	-
Decrease in income tax expense (2 000 x 28%); (3 000 x 28%)	(560)	(840)	-
Decrease in profit	1 440	2 160	-
Increase in inventory	6 000	8 000	11 000
Increase in current tax liability / SA Revenue Service (6 000 x 28%)	(1 680)	-	-
Increase in deferred tax liability (8 000 x 28%); (11 000 x 28%)	-	(2 240)	(3 080)
Increase in equity	4 320	5 760	7 920
Adjustment to retained earnings at beginning of 2013			7 920



LECTURER'S COMMENT

In prior periods the carrying amount of inventory is based on the first-in, first-out method and the tax base of inventory is based on the last-in, first-out method, resulting in temporary differences for deferred tax purposes. Therefore the deferred tax line item in the statement of financial position and the statement of profit or loss and other comprehensive income are restated in the comparative periods.

However, in the current period both the carrying amount and the tax base of inventory are based on the first-in, first-out method of inventory valuation and therefore there is no temporary difference for deferred tax purposes.

Calculation of deferred tax relating **only** to inventory:

	Carrying amount R	Tax base R	Temporary difference R	Deferred tax balance Dr/(Cr) @28% R	Deferred tax movement Dr/(Cr) R
2012	391 000	380 000	11 000	(3 080)	3 080
2013	402 000	394 000	8 000	(2 240)	(840)
2014	420 000	420 000	–	–	(2 240)



HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING POLICY?

Both the cumulative and period-specific effect for all comparative periods are available, therefore the change in accounting policy can be applied retrospectively. Retrospective application requires a new accounting policy to be applied to transactions **as if that policy has always been applied.** The following journal entries should be prepared to record the change in accounting policy:

Please note: The following current and deferred tax journals relate only to the tax implications of inventory.

1 March 2012	Dr R	Cr R
Inventories (SFP)	11 000	
Deferred tax (SFP)		3 080
Retained earnings (Equity)		7 920
Restate the earliest period presented for the cumulative effect of the change in accounting policy		

SOLUTION QUESTION 14 (continued)

HOW SHOULD I RECORD THE CHANGE IN ACCOUNTING POLICY? (continued)		
	Dr	**Cr**
28 February 2013	**R**	**R**
Cost of sales (P/L)	3 000	
Inventories (SFP)		3 000
Restate the period specific effect of the change in accounting policy for 2013		
Deferred tax (SFP)	840	
Deferred tax expense (P/L)		840
Tax effect for the period specific effect of the change in accounting policy for 2013		
28 February 2014		
Cost of sales (P/L)	2 000	
Inventories (SFP)		2 000
Restate the period specific effect of the change in accounting policy for 2014		
Deferred tax (SFP)	2 240	
Deferred tax expense (P/L)		2 240
Current tax expense (P/L)	1 680	
Current tax payable / SA Revenue Service (SFP)		1 680
Tax effect for the period specific effect of the change in accounting policy for 2014		

2. **Events after the reporting period**
   On 10 April 2014 the company obtained a second mortgage bond of R320 000 at an interest rate of 10% per year from Cat Bank Ltd, in order to finance the expansion of the company's trading premises. The land and building serve as security for the mortgage loan.

3. **Provision for severance package of managing director**

	2014	**2013**
	R	**R**
Carrying amount beginning of year	180 000	-
Provision used (40 000 + 130 000)	(170 000)	-
Unused provision reversed during the year	(10 000)	-
Provision created during the year	-	180 000
Carrying amount end of year	-	180 000

The dispute with the managing director, Mr Union, regarding his severance package was resolved during November 2013 when it was finally settled.

d) **IFRS 13 – Fair value measurement defines fair value as**
- the price;
- that would be received to sell an asset or paid to transfer a liability;
- in an orderly transaction;
- between market participants;
- at the measuring date.

The characteristics that should be taken into account is
- the condition and location of the asset; and
- only restriction, if any, on the sale or use of the asset.

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