UNIVERSITY
OF
JOHANNESBURG

DEPARTMENT OF ACCOUNTANCY

ACCOUNTING - 200

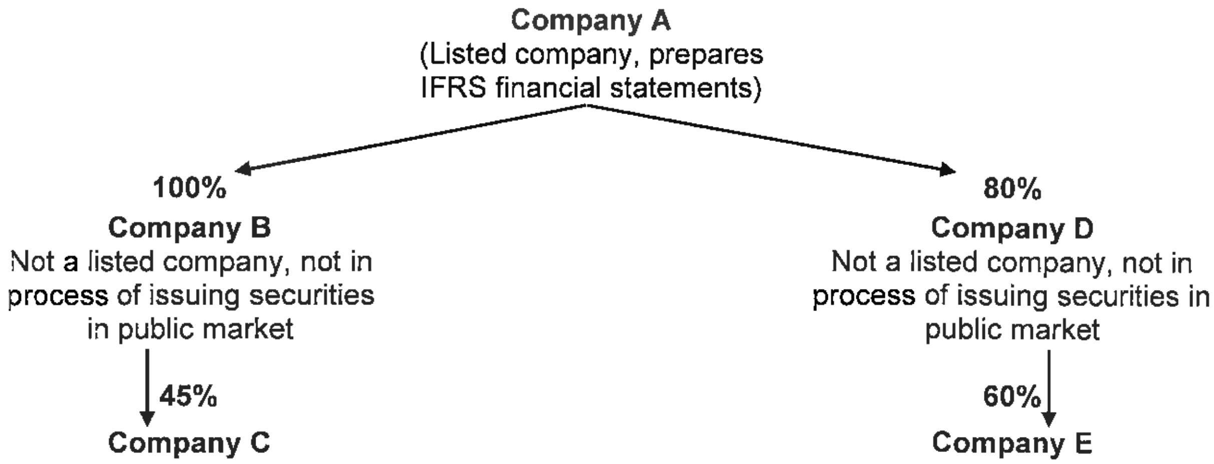
ASSESSMENT OPPORTUNITY 6
8 NOVEMBER 2014

ASSESSORS:	PROF N STEGMANN MS M MALAN MS L COLMAN
MODERATORS:	MR DENNIS DEYSEL MR AHMED MOHAMMADALI-HAJI
TIME:	3 HOURS
MARKS:	150

- THE ASSESSMENT OPPORTUNITY PAPER CONSISTS OF 4 QUESTIONS AND 11 PAGES (front page included).
- SILENT NON-PROGRAMMABLE CALCULATORS ARE ALLOWED.
- SHOW ALL CALCULATIONS.
- **IF PENCIL OR TIPPEX WAS USED ON THE ANSWER SHEET OR OPEN SPACES AND EMPTY PAGES ARE NOT CROSSED OUT, IT DOES NOT QUALIFY FOR A REMARK.**

QUESTION 1 **(15 MARKS)**

The following group structure is presented to you:



ADDITIONAL INFORMATION:

1. The share capital of all of the companies consists of "ordinary" shares that give the holders proportionate voting rights.

2. None of the companies have other parties holding potential voting rights and there are no contractual arrangements that may result in other parties having some power over the investees.

3. Company B controls the composition of the board of directors by having the power to appoint or remove the majority of Company C's directors.

4. Decisions about relevant activities of all companies are made through a majority vote at shareholders' meetings.

REQUIRED:

1.1 Discuss what is required to establish a parent-subsidiary relationship, *i.e.* when does a parent-subsidiary relationship exist. (5)

1.2 Identify the parent-subsidiary relationship(s) that exist in the group above and state why you are of such opinion. (5)

1.3 Discuss how Company A can ensure that it would be the only company in the group that has to prepare consolidated financial statements. (5)

QUESTION 2 **(35 MARKS)**

Coldplay Ltd ("Coldplay") is a company which manufactures sportswear and equipment for outdoor winter activities such as skiing and ice climbing. The following is an *extract* of the Statement of Financial Position of Coldplay as at 31 December 2013. You may assume that all amounts presented have been correctly calculated, unless otherwise indicated.

Statement of Financial Position		**2013**	**2012**
	Note	**R**	**R**
Current assets			
Accounts receivable	1	7 100 000	1 120 000
Prepaid electricity		50 000	20 000
Raw material		1 800 000	1 500 000
Finished goods	2	850 000	160 000
Bank		380 000	148 641
Non-current assets			
Property, plant and equipment	2	10 560 000	9 400 000
Investment property	3	12 600 000	11 000 000
Current liabilities			
Accounts payable		3 750 000	1 450 000
Rent received in advance	3	150 000	0
Tax payable/SARS	5	63 000	60 000
Non-current liabilities			
8% debentures	4	?	0
Dismantling cost provision	2	?	0
Equity			
Share capital	6	2 520 000	1 500 000
Retained earnings		7 100 890	6 540 600

The following balances appeared, inter alia, in the **Statement of Comprehensive Income** of Coldplay for the year ended 31 December 2013:

	Note	**2013**
		R
Income		22 778 500
Cost of sales		14 350 000
Net operating costs	7	3 123 886

ADDITIONAL INFORMATION:

1. **Accounts receivable**

   The accounts receivable balance is net of an allowance for doubtful debt of R90 000 (2012: R70 000).

QUESTION 2 (continued)

2. Property, plant and equipment

Property, plant and equipment is measured according to the cost model. On 1 January 2013 a new machine was purchased for cash. This machine has a total useful life of 4 years and would have to be dismantled at an estimated cost of R180 000 at the end of its useful life (cost of finance is 9,79% p.a.).

During the year, Coldplay disposed of a motor vehicle that had a cost of R120 000, and at the date of disposal, accumulated depreciation of R30 000. The fair value of the vehicle on this date was R100 000. The motor vehicle was sold to Oasis Ltd in exchange for a machine with a fair value of R105 000. No other disposals or acquisitions took place during the year.

Total depreciation for the year was R1 500 000; 20% of this depreciation was capitalised to the inventory for the year.

3. Rent received in advance

Coldplay owns a building which is rented to a third party and is measured in accordance with the fair value model. The building was purchased in 2008, and had a fair value of R12,6 million on 31 December 2013 (2012: R11 million). A new rental agreement was entered into on 2 January 2013, and stipulates that the tenant is required to pay upfront two months' rental, together with one month's rental paid as a deposit. Monthly rental is R50 000. The deposit will be reimbursed at the end of the lease term, and is included in rent received in advance.

4. 8% debentures

10 000 R200 8% debentures were issued at par value on 1 April 2013, with interest payable annually on 30 March. Transaction costs of R16 141 were incurred at the issue date. The debentures are redeemable on 30 March 2018 at par. The effective rate on the debentures is 8,2%.

5. Taxation

At the 31 December 2013, the company reliably estimated its tax expense for the year at R264 000. The company made a third provisional payment of R60 000 on 31 July 2013 in respect of the 2012 year of assessment.

6. Equity

On 30 June 2013 an interim dividend of R600 000 was declared in terms of which shareholders were given the option to take up 1 share for every 10 shares held or receive the dividend in cash. 80% of the shareholders elected to receive the cash dividend which was paid on 31 August 2013.

QUESTION 2 (continued)

7. Expenses

Net operating costs include, amongst other income and expenses, the following:

Depreciation on property, plant and equipment	?
Impairment of property, plant and equipment	R750 000
Electricity expense	R 80 000
Fair value adjustment (Investment property)	?
Profit on sale of motor vehicle	?

REQUIRED:

Prepare the **statement of cash flows** according to the direct method for Coldplay Ltd for the year ended 31 December 2013.

Please note:

- All calculations should be shown clearly.
- No comparatives are necessary.

QUESTION 3 **(50 MARKS)**

Travelex Ltd, a listed company in the travel goods industry, was incorporated during 2001 with an issued share capital of:

- 150 000 12% cumulative, non-redeemable preference shares at R1 each;
- 200 000 10% non-cumulative, non-redeemable preference shares at R1 each, and
- 400 000 ordinary shares issued at R1.50 each.

Since incorporation the only changes to the capital structure of Travelex Ltd were a fresh issue of 100 000 ordinary shares at R2 on 1 July 2012, and a capitalisation issue of 1 share for every 5 held at a value of R1 per share on 1 April 2013.

The following are the draft statement of profit and loss and comprehensive income of Travelex Ltd for the reporting period ended 31 December 2013:

TRAVELEX LTD DRAFT STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2013		
	2013	**2012**
	R	**R**
Revenue	7 200 000	5 400 000
Cost of sales	(3 600 000)	(2 160 000)
Gross profit	3 600 000	3 240 000
Other income	550 000	300 000
Other expenses	(880 000)	(760 000)
Profit before tax	3 270 000	2 780 000
Income tax expense	(948 300)	(806 200)
Profit for the year	2 321 700	1 973 800
Other comprehensive income for the year	-	-
Total comprehensive income for the year	**2 321 700**	**1 973 800**

ADDITIONAL INFORMATION:

1. **Retained earnings and dividends**

   The retained earnings at the beginning of the 2012 reporting period was R579 082.

   An ordinary dividend of R0.15 per share were declared and finalised on 20 December 2013. The preference dividend was also declared and paid on this date No dividends were declared or paid during the 2012 reporting period.

2. **Fictitious sales**

   Shortly before the end of December 2013, the company auditors discovered that the sales manager, Mr Lex, had recorded several fictitious credit sales invoices amounting to R150 000 during the 2011 reporting period and R500 000 during the 2012 reporting period. Mr Lex's motive in doing this was to obtain additional sales commission, earned at 5% of the total annual sales generated by him. The commission was paid to Mr Lex at the end of 2011 and 2012 respectively. The above is considered to be material and no entries have been processed to correct the error. Assume that the cost of sales figures are correct in all the years mentioned.

QUESTION 3 (continued)

3. **Change in estimated useful life**

On 1 April 2010, Travelex Ltd bought the rights to manufacture a range of light weight, indestructible umbrellas at a cost of R750 000. The cost was correctly recognised as an intangible asset and is being amortised over its expected useful life of 15 years to a nil residual value using the straight-line method.

During December 2013 it was determined, however, that the total expected useful life of the purchased right was only 10 years. The financial manager calculated and recognised the amortisation for the current reporting period using the estimated useful life of 15 years.

4. **Equipment**

All of the company's equipment was purchased on 1 March 2010 at a cost of R1 000 000. At that date the residual value was estimated at R200 000. Equipment is measured using the cost model and Travelex Ltd accounts for depreciation on equipment on the straight-line basis over the useful life of 10 years.

The directors realised that new technological advances made their equipment redundant and therefore decided to replace the equipment with newer models from an overseas supplier. The old equipment was sold on 28 February 2013 at a profit of R40 000.

The new equipment was purchased on 1 May 2013 (FOB) from an Italian supplier for €150 000. The cost to import amounted to R200 000 and costs of staff training on the new machines amounted to R10 000. The Italian supplier was paid on 15 July 2013 while the equipment was taken into use on 31 May 2013 (the original residual value still applies).

The following exchange rates apply:

1 May 2013 - R12 for €1
31 May 2013 - R12.40 for €1
15 July 2013 - R12.52 for €1

None of the transactions relating to equipment have been taken into account for the current reporting period.

5. **Investment**

Travelex Ltd acquired an investment of 10 000 shares in Travelcorp Ltd for R65 per share on 1 February 2013. At the end of the reporting the shares in Travelcorp Ltd were trading at R72 per share. Travelex Ltd elected to recognise changes in fair value in other comprehensive income. The change in fair value has not been recorded yet.

6. **Taxation**

Assume that the income tax expense as shown in the draft statement of profit an loss and other comprehensive income is correct. Ignore all other tax implications.

QUESTION 3 (continued)

7. **Provision for litigation**

The company has a segment of the business that organises and guides paddling tours in South Africa. In 2012 on one such tour, a canoe overturned and a young boy was injured. During the reporting period ended 31 December 2012, Travelex Ltd created a provision of R300 000 for probable losses from litigation in progress.

During the current reporting period, the legal advisors for the company concluded that it was very unlikely that the company would be held liable for the injury caused, as all clients were required to sign an indemnity form. Additionally, the young boy had not complied with safety regulations during the tour. The marketing director however feel that should the company not in fact be held liable, that it would make a token payment of R20 000 to cover costs incurred by the family as a result of the accident. The financial director would like to recognise this R20 000 as a provision at 31 December 2013. The company has not announced its intention to make such a token payment by the reporting period date.

8. **Event after the reporting period**

A debtor that owed Travelex Ltd R100 000 at 31 December 2013 had their factory destroyed in a fire on 26 January 2014. As a result this debtor filed for insolvency and will probably only be able to pay 30% of the amount owed once the liquidation process has been finalised. The financial statements will be authorised and signed on 14 March 2014.

REQUIRED:

3.1 Discuss how the provision for litigation should be accounted for in the financial statements of Travelex Ltd for the year ended 31 December 2013. Your answer should include any journal entries that would be required to correctly reflect this provision. (6)

3.2 Discuss whether the event after the reporting period should be adjusted for or not in the financial statements of Travelex Ltd for the year ended 31 December 2013. If the event is adjusting, provide the journal entries. If the event is non-adjusting, provide the note to disclose the event in the financial statements of Travelex Ltd at 31 December 2013. (8)

3.3 Prepare the statement of profit and loss and other comprehensive income for Travelex Ltd for the year ended 31 December 2013 according to IFRS. (24)

3.4 Prepare the statement of changes in equity (retained earnings column only) for Travelex Ltd for the year ended 31 December 2013 according to IFRS. (12)

Please note: Comparative figures are required for the SCE **only**.
Notes are not required (except as might be required under 3.2).
Round off all amounts to the nearest Rand.

QUESTION 4 **(50 MARKS)**

Putumayo Ltd (P Ltd) owns 80% of the Class A shares and 25% of the Class B 20% preference shares of Mexican Music Ltd (MM (Pty) Ltd). The issued Class B 20% preference share capital is R100 000.

The Class B 20% preference shares have the following **preferential** rights:

- their dividend payment has priority over that of the Class A shareholders;
- the dividends are cumulative and are payable on 30 September each year; and
- shareholders will receive a proportionate share of the net assets available for distribution upon liquidation of the acquiree.

The following are the condensed statements of profit or loss and other comprehensive income and the statements of changes in equity of P Ltd and its subsidiary MM (Pty) Ltd for the reporting period ended 30 September 2014:

EXTRACT FROM THE STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 2014

	P Ltd	MM (Pty) Ltd
Revenue	1 188 000	982 000
Cost of sales	(644 000)	(589 000)
Gross profit	544 000	393 000
Other income	212 000	142 000
Gain on disposal of plant	-	5 000
Operating expenses	(426 000)	(382 000)
Profit before tax	330 000	158 000
Income tax expense	(90 000)	(44 000)
PROFIT FOR THE YEAR	240 000	114 000
Other comprehensive income		
Mark-to-market reserve (fair value gain on investment)	5 000	6 000
Other comprehensive income for the year	5 000	6 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	245 000	120 000

EXTRACT FROM THE STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 SEPTEMBER 2014

	Mark-to-market reserve		Retained earnings	
	P Ltd	MM (Pty) Ltd	P Ltd	MM (Pty) Ltd
Balance at 1 October 2013	15 000	12 000	110 000	90 000
Changes in equity for 2014				
Total comprehensive income for the year:				
Profit for the year	-	-	240 000	114 000
Other comprehensive income	5 000	6 000	-	-
Dividend – Class A: Final: 2013	-	-	(40 000)	(8 000)
Interim: 2014	-	-	(30 000)	(10 000)
Class B: 20% Preference	-	-	-	(40 000)
Balance at 30 September 2014	20 000	18 000	280 000	146 000

QUESTION 4 (CONTINUED)

ADDITIONAL INFORMATION:

1. When P Ltd acquired its interest in MM (Pty) Ltd on 1 October 2010 it considered an item of plant (original cost R180 000, carrying amount R108 000) to be worth R150 000. P Ltd confirmed the original total useful life of the plant of 10 years. MM (Pty) Ltd did not recognise this revaluation in its individual records. On 1 April 2014 MM (Pty) Ltd sold this plant for R50 000.

2. At 1 October 2010 the equity of MM(Pty) Ltd consisted of the following:

	R
Class A share capital (10 000 shares)	250 000
Class B 20% preference share capital (10 000 shares)	100 000
Retained earnings	40 000
Mark-to-market reserve	8 000

   At 30 September 2014 the fair value of the investment in Class A shares (in the records of P Ltd) amounted to R300 000.

3. The share capital of P Ltd, which had remained unchanged since the company's incorporation is as follows:

	R
Class A share capital (100 000 shares)	1 000 000

4. P Ltd elected to measure the non-controlling interests in the acquiree at their fair value at the acquisition date. The fair value of the Class A non-controlling interests at acquisition date (1 October 2010) was R70 000

5. P Ltd obtained its 25% interest in the Class B 20% preference share capital on 1 October 2012 at R25 000. There were no arrear preference dividends at that date. The fair value of the preference non-controlling interests amounted to R75 000 at that date.

   The fair value of the investment in the Class B 20% preference shares of MM (Pty) Ltd (in the records of P Ltd) has remained unchanged since acquisition and no amount was recognised in the mark-to-market reserve in relation to this investment.

   The preference dividend for the 2013 reporting period had however not been paid, and was paid on 30 September 2014 together with the current reporting period's preference dividend. The preference shareholders have not assumed any voting rights as a result of the arrear preference dividends.

6. MM (Pty) Ltd sells inventories to P Ltd at a mark-up of 40% on cost price. During the 2014 reporting period total inventories sold to P Ltd amounted to R230 000 (2013: R180 000). Inventory purchased from MM (Pty) Ltd, still owned by P Ltd at 30 September 2014 was R31 500 (2013: R21 000; 2012: R28 000).

7. P Ltd rents premises to MM (Pty) Ltd for a monthly rental of R10 000. The rental income is included in the "Revenue" of P Ltd.

8. Both companies include dividends received on investments in equity instruments in "other income".

QUESTION 4 (CONTINUED)

REQUIRED:

4.1 Prepare the pro-forma journal entries to account for any fair value adjustments on acquisition as well as for all intragroup transactions for the year ended 30 September 2014. (20)

4.2 Prepare the consolidated statement of profit or loss and other comprehensive income and the consolidated statement of changes in equity for the year ended 30 September 2014 for the P Ltd Group to comply with IFRS. (30)

Please note:

Show all calculations clearly as principle marks are based on them.