



UNIVERSITY
OF
JOHANNESBURG

DEPARTMENT OF ACCOUNTANCY

ACCOUNTING 300 / BCTA

FINAL ASSESSMENT OPPORTUNITY 10 NOVEMBER 2014

ASSESSORS: MR D DEYSEL
MS C HATTING
MS K KEKANA

MODERATORS: MS S CARSHAGEN
MR A MOHAMMADALI-HAJI
MR J STRENG
MR D MONG (University of North West)

TIME: 4 HOURS

MARKS: 150

- THE ASSESSMENT OPPORTUNITY PAPER CONSISTS OF 3 QUESTIONS AND 10 PAGES (front page included).
- SILENT NON-PROGRAMMABLE CALCULATORS ARE ALLOWED.
- SHOW ALL CALCULATIONS.
- START EVERY QUESTION AT THE TOP OF A PAGE.
- IF PENCIL OR TIPPEX WAS USED ON THE ANSWER SHEET, IT DOES NOT QUALIFY FOR REMARKING.
- SCRATCH OUT OPEN SPACES AND EMPTY PAGES.

QUESTION 1

(50 MARKS)

Candy Ltd (hereafter "Candy") is a company incorporated in South Africa and is listed on the JSE. The following information pertains to Candy, a leading manufacturer and distributor of sweets as well as the companies in which it has its investments.

The relevant financial information for the various companies in the Candy Ltd group, before the application of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IAS 28 *Investments in Associates and Joint Ventures*, is as follows:

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2014					
	Candy	Sour-Worms	Speckled-Eggs	Wine-Gums	Soft-Mints
	R'000	R'000	R'000	R'000	R'000
Assets					
Non-current assets					
Property, plant and equipment	7 399	1 582	13 628	4 915	2 375
Investment in SourWorms Ltd at cost	1 500	-	-	-	-
Investment in Speckled Eggs Ltd at cost	-	4 500	-	-	-
Investment in WineGums Ltd at cost	2 000	-	-	-	-
Investment in SoftMints Ltd at cost	20	-	-	-	-
Intangible assets	-	4 600	-	-	-
Loan to Speckled Eggs Ltd	12 978	-	-	-	-
Current assets					
Trade and other receivables	-	2 390	5 000	1 600	-
Inventory	10 000	5 000	7 500	2 800	3 000
Total assets	33 897	18 072	26 128	9 315	5 375
Equity					
Share capital	250	100	100	50	50
Retained earnings	16 847	11 672	11 220	5 125	825
Non-current liabilities					
Loan from Candy Ltd	-	-	12 978	-	-
Deferred tax	4 800	2 500	680	390	-
Current liabilities					
Trade and other payables	12 000	3 800	1 150	3 750	4 500
Total equity and liabilities	33 897	18 072	26 128	9 315	5 375

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2014					
	Candy	Sour-Worms	Speckled-Eggs	Wine-Gums	Soft-Mints
	R'000	R'000	R'000	R'000	R'000
Profit before tax	10 455	8 772	4 445	1 575	285
Income tax	(3 500)	(2 800)	(1 780)	(800)	(35)
Profit for the year	6 955	5 972	2 665	775	250
Total comprehensive income	6 955	5 972	2 665	775	250

QUESTION 1

(CONTINUED)

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2014					
Retained earnings:	Candy	Sour-Worms	Speckled-Eggs	Wine-Gums	Soft-Mints
	R'000	R'000	R'000	R'000	R'000
Balance as at 01/01/2013	5 037	5 200	5 085	4 622	390
Total comprehensive income for the year	9 855	2 300	3 470	228	185
Dividend	(2 500)	-	-	-	-
Balance as at 01/01/2014	12 392	7 500	8 555	4 850	575
Total comprehensive income for the year	6 955	5 972	2 665	775	250
Dividend	(2 500)	(1 800)	-	(500)	-
Balance as at 31/12/2014	16 847	11 672	11 220	5 125	825

SourWorms Ltd

On 1 January 2013 Candy purchased 80% of the shares of SourWorms Ltd (hereafter "SourWorms") and from that date Candy has exercised control over SourWorms as per the definition of control in IFRS 10 *Consolidated Financial Statements*. All assets and liabilities of SourWorms were considered to be fairly valued except for the following items:

1. SourWorms failed to declare certain foreign taxable income to the tax authorities during 2012, and, as at the acquisition date was in negotiations with the South African Receiver of Revenue (SARS). Although the legal team could confirm that SourWorms had a present legal obligation they were uncertain regarding the final amount that SourWorms would be liable to SARS for. As at 1 January 2013 the legal team estimated the fair value of the obligation at the acquisition date to be R2 500 000. SARS does not allow a tax deduction for the payment of the taxes.

At 31 November 2013 SARS issued a final verdict for the legal dispute and SourWorms paid an amount of R3 300 000 to settle the claim against them.

SpeckledEggs Ltd

SourWorms acquired 40% of the issued share capital of SpeckledEggs Ltd (hereafter "SpeckledEggs") on 1 January 2014. In addition to the shareholding, SourWorms signed a contractual agreement with the other shareholders of SpeckledEggs granting SourWorms control, as defined in terms of IFRS 10 *Consolidated Financial Statements*, over the operation of SpeckledEggs. All assets and liabilities at the acquisition date were deemed to be fairly valued.

SpeckledEggs decided to erect a building. However their current cash flow was not sufficient to cover all of the costs of erecting the building. SpeckledEggs obtained a specific loan from Candy on 1 January 2014 and began the construction of the building on the same day. The building meets the definition of a qualifying asset as per IAS 23 *Borrowing Costs* and as such SpeckledEggs applied the requirements of IAS 23 *Borrowing Costs* to the borrowing costs incurred in relation to the construction of the building in its separate financial statements. The building was expected to be become available for use in the manner intended by management on 31 January 2015.

The interest on the loan for the period 1 January 2014 to 31 December 2014 amounts to R1 180 000. The interest earned on any surplus funds invested is not material to the calculation of the borrowing costs capitalised.

QUESTION 1

(CONTINUED)

WineGums Ltd

Candy acquired a 28% equity interest in WineGums Ltd (hereafter "WineGums") on 1 January 2012 for R2 000 000. Since the acquisition date, Candy has exercised significant influence over the financial and operating activities of WineGums. Retained earnings of WineGums at the acquisition date amounted to R3 500 000. All the assets and liabilities of the associate were fairly valued at the date of acquisition.

SoftMints Ltd

Candy acquired a 40% interest in SoftMints Ltd (hereafter "SoftMints") at its incorporation. In terms of the contractual agreement, Candy, together with other operators, exercise joint control over the economic activities of SoftMints. The joint arrangement has been correctly classified as a joint operation. The contractual arrangement specifies that all assets, liabilities, income and expenses are allocated according to the respective interests held by the operators.

Additional Information

- Assume that all entities in the group are VAT vendors.
- Assume all amounts exclude VAT unless indicated otherwise.
- Assume a corporate tax rate and effective tax rate applicable to all companies of the group of 28% and a capital gains tax inclusion rate of 66.6%.
- Management elected to measure the non-controlling interest at their proportional share in the net assets of the subsidiary at the acquisition date

REQUIRED:

- a) Prepare the pro-forma journal entries relating **ONLY** to the **associate (WineGums Ltd)** and the joint operation (**SoftMints Ltd**) for the year ended **31 December 2014**. Your journal entries should clearly indicate where an account is situated in the financial statements, i.e. statement of financial position (SFP); profit or loss (P/L); other comprehensive income (OCI); or statement of changes in equity (SCE). Please include all calculations as marks are awarded for them. Round off all amounts R'000. (11)
- b) Prepare an abridged **consolidated statement of profit or loss and other comprehensive income** for the Candy Ltd group for the year ended **31 December 2014** starting with the profit before tax. Comparatives are not required. The attribution to non-controlling interest in terms of paragraph 83 of IAS 1 *Presentation of Financial Statements* is required. Show all calculations clearly as marks are awarded for these. Round off all amounts R'000. (18)
- c) Prepare the **consolidated statement of changes in equity** for the Candy Ltd group for the year ended **31 December 2014**. Include **ONLY** the following columns: (21)
- **Retained Earnings**
 - **Non-Controlling Interest**
- Comparatives and the total column are not required. Show all calculations clearly as marks are awarded for these. Round off all amounts R'000.

QUESTION 2

(60 MARKS)

Extraction Ltd (hereafter "Extraction") is a JSE-listed company mining and processing vanadium ore on the Bushveld Complex in South Africa. Vanadium is used in, among others, high-strength steels, high capacity energy storage and robotics. Vanadium ore is extracted through opencast mining which is a surface mining technique that differs from extractive methods that require tunnelling into the earth. The mining process relies heavily on a healthy workforce and is subject to local environmental laws. The process to produce vanadium flakes from the ore involves a Salt Roast process that requires the vanadium ore to be roasted in a rotating oven at up to 1 150 °C.

Extraction incurred the following significant transactions during the financial year ended **28 February 2014**:

1. Fraudulent acts by senior management

Subsequent to the release of the financial statements for the financial year ended 28 February 2013, Extraction discovered that fraudulent acts were perpetrated by senior members of management in a division of the entity in an attempt to hide poor financial performance due to improper management. The investigation into the fraudulent activities was concluded towards the end of August 2013.

The investigation revealed that the senior members of management attempted to overstate the financial performance of the division for the financial years ended 28 February 2012 and 2013 by recognising sales in February 2012 and 2013 for which the performance obligations were only satisfied in March 2012 and 2013 respectively. The amount of sales incorrectly reported amounted to R8 million for 2012 and R12 million for 2013. The resulting trade receivables were settled in cash during April 2012 and 2013 respectively. Sales are priced at cost plus 60%.

The sales were also reported in the incorrect financial periods within the current tax assessments submitted to the South African Revenue Services (SARS). SARS informed Extraction that it will re-open the assessments for 2012 and 2013. Extraction had no outstanding current tax liability in respect of the sales as at 28 February 2014. Extraction however incurred a penalty of R2 million due to the erroneous returns submitted, payable to SARS after the error was reported. The penalty was only settled in cash during April 2014. SARS does not allow a deduction for the penalty. The penalty payable should be presented as part of "Trade and other payables" on the face of the statement of financial position.

2. Wage dispute with workers' union

On 31 August 2013 a three-week workers strike at Extraction's vanadium mine came to an end after management and the workers' union agreed on a 10% wage increase in the basic salary per month of its mine workers effective from 1 September 2013. The wage increase was communicated to all workers and in the public media on 31 August 2013. The basic salary per month per worker, before the increase, amounted to R11 500. Extraction employs 400 mine workers. Basic salaries per month are paid in cash on the 25th of each month. The wage increase did not result in any contracts that Extraction has entered into becoming onerous.

3. Power purchase agreement

On 1 September 2013 Extraction entered into a power purchase agreement with the national power company for the supply of power, not available from the normal national power grid, at its mine. In order to deliver the power required by Extraction, the national power company constructed a power generator at the mine site. Management **correctly** assessed that the agreement should be accounted for as a lease. The minimum lease payments are R500 000 per month for 10 years, payable at the end of each month and a lump-sum payment on the last date of the lease term of R5 million. The legal title of the power generator remains with the national power company. The fair value of the power generator on 1 September 2013 amounts to R35 million.

QUESTION 2

(CONTINUED)

Extraction interprets "substantial" as referred to in IFRS as 90% or more. Extraction can borrow funds for 10 years at a rate of 15% p.a. Lease related liabilities are presented in a separate line on the face of the statement of financial position.

SARS does not view the contract as a lease but allows the R500 000 payment per month as a deduction in the calculation of current taxation when incurred. SARS however will not allow a deduction for the R5 million lump-sum payment. SARS also does not allow any deduction in respect of the power generator constructed on the mine property.

4. Contract with customer

Extraction committed and signed a sales agreement, that has commercial substance, with a specific customer on 2 February 2014 to sell a specified volume of vanadium flakes for a total consideration of R5 million. The customer is located in China and the goods will be transported via a ship from Port Elizabeth to Rizhao Port in China. The customer has a good reputation of always settling its debts on time. The customer will use the vanadium flakes within its robotics operations.

The contractual terms of the sale agreement state that insurance is taken out by Extraction for the period the vanadium flakes are in transit. However, the terms go on to say that:

"The seller must pay the costs and freight necessary to bring the goods to the named port of destination, but the risk of loss or of damage to the goods, as well as any additional costs due to events occurring after the goods cross the ship's rail, are transferred from the seller to the buyer when the goods pass the ship's rail at the port where the goods are loaded onto the ship."

In order to comply with these terms Extraction takes out an insurance policy, which means that Extraction would claim for any loss or damage to the vanadium flakes until it passes the ship's rail (that is, the vanadium flakes are officially documented as being loaded as part of the ship's cargo) in Port Elizabeth. From this point on, the insurance policy is transferred to the customer. The customer will need to make a claim directly to the insurers (not via Extraction) for any vanadium flakes lost in transit once it crosses the ship's rail in Port Elizabeth.

As stipulated in the contract, the customer paid an amount of R2 million upfront, in cash, on 2 February 2014. The vanadium flakes were officially documented and loaded as part of the ship's cargo on 5 March 2014 and arrived in Rizhao Port in China on 25 March 2014. The customer paid the balance of the purchase price of R3 million, as required in the contract, on 5 March 2014 when the goods crossed the ship's rail and the insurance policy was transferred to the customer.

Revenue received in advance is presented in a separate line on the face of the statement of financial position.

Additional information

- Extraction chose to present current and non-current liabilities on the face of the statement of financial position in terms of IAS 1 *Presentation of Financial Statements* paragraph 60.
- Assume a corporate tax rate of 28%.
- If not specifically stated otherwise, assume that SARS includes all income in gross income at the earliest of receipt or accrual and allows a deduction for any expense under section 11(a).
- Excluding the transactions discussed in point 1 to 4 above, Extraction has a deferred tax liability of R5 million as at 28 February 2014.
- Extraction meets the requirements in IAS 12 *Income Taxes* paragraph 74 to offset any deferred tax assets and deferred tax liabilities.
- Ignore VAT.

QUESTION 2

(CONTINUED)

REQUIRED:

- a) As far as the information allows, list five issues that you believe Extraction Ltd should address in its sustainability report. (5)
- b) Prepare the relevant note required in terms of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to the annual financial statements of Extraction Ltd for the year ended **28 February 2014** as it relates to the fraudulent acts perpetrated by senior members of management (point 1 in the question). Your answer must comply with International Financial Reporting Standards. Show all calculations. Round all amounts to the nearest **R'000**. Your note does **not** need to include the impact on basic and dilutive earnings per share. (14)
- c) Discuss the accounting treatment of the 10% wage increase (point 2 in the question) in the financial statements of Extraction Ltd for the year ended **28 February 2014** specifically as it relates to the recognition of any additional liabilities. Your answer should include relevant calculations and need not address presentation and disclosure. (6)
- Communication Skills: Logical argument** (1)
- d) Discuss when and at what amount the **revenue** from the contract with the customer (point 4 in the question) should be **recognised** by Extraction Ltd. Your answer should refer to IFRS 15 *Revenue from Contracts with Customers* by applying the five-step approach, suggested in the standard, to the transaction. (15)
- Communication Skills: Logical argument** (1)
- e) As far as the information allows, prepare the **liability section** of the statement of financial position for Extraction Ltd for the financial year ended 28 February 2014. Your answer should include a calculation of the deferred tax consequences, using the **asset and liability method**, of the transactions provided in point 1 to 4 in the question. Comparative information, supporting notes and accounting policies are **not** required. Show all calculations as marks are awarded for them. Round all amounts to the nearest **R'000** and all interest rates to **two decimal places**. (18)

(60)

QUESTION 3

(40 MARKS)

M&S (Pty) Ltd (hereafter "M&S") is a company that specialises in antique car sales. M&S source old, collectible cars worldwide in order to restore and resell them. The company has gained popularity over the years and has become a very well-known brand. M&S is located in Johannesburg and uses the Rand as it's functional and presentation currency. The company reports in terms of IFRS and has a 30 September year end.

Repurchase of Shares

M&S is proud of its relations with its shareholders and takes the utmost care in ensuring that all activities are executed in their best interest. M&S received news that a significant shareholder, Ruby Moon, is considering selling its shares in M&S, due to a change in its business strategy. M&S would prefer not to have a new shareholder to unsettle the existing shareholders and so in response M&S approached Ruby Moon with an offer to purchase a put option on 1 October 2012 to buy their existing shares for R450 per share. The put option in no way compels Ruby Moon to sell their shares back to the company but is priced such that it is favourable to Ruby Moon. On 1 October 2012 Ruby Moon paid M&S the premium equal to the fair value of the put option in cash. Ruby Moon currently holds 335 000 shares in M&S. The option is currently exercisable by Ruby Moon and expires on 30 September 2015.

The fair values of the put option, over the term of contract, are as follows:

Date	Fair value (per share) of the put option written by M&S and favourable to Ruby Moon
1 October 2012	R104
30 September 2013	R198
30 September 2014	R145

Sale to Traineacks

The owner of Traineacks, an Argentinian based company, visited the offices of M&S and saw an old train carriage that was used as a display unit in the showroom. He became very excited about the valuable find and offered to purchase the carriage if M&S agreed to restore the unit as well. On 28 January 2014 M&S agreed to sell the carriage to Traineacks. The selling price was set at P50 000 (Argentinian Peso) to be paid by 30 June 2014. A legal contract was signed on 28 January 2014 in confirmation of the sale. The carrying amount of the carriage in M&S' records was R23 000 on 31 March 2014. M&S had to incur costs of R20 000 to restore the carriage in terms of the sales agreement. The restoration was completed by 1 March 2014.

The carriage was shipped CIF (cost, insurance, freight) at a cost of R1 000 (which was paid immediately) on 4 March 2014. Risks and rewards only transferred when the carriage arrived at the Argentinian harbour on 31 March 2014.

Traineacks was able to make an initial payment of 40% of the selling price on 30 June 2014 but then began to experience cash flow difficulties. M&S agreed for Traineacks to pay the outstanding balance by 30 October 2014 (assume that the effects of time value of money are negligible).

The following spot rates apply for the exchange of R1 in return for Argentinian Pesos:

1 October 2013	0.67
28 January 2014	0.43
4 March 2014	0.29
31 March 2014	0.30
30 June 2014	0.32
30 September 2014	0.25
Average rate 1 April 2014 – 30 September 2014	0.28

QUESTION 3

(CONTIUNED)

Financial Risks

As per good corporate governance principles, M&S has established a risk committee to thoroughly identify and mitigate the risks that the company may face. A few areas of concern have been raised that need to be discussed at the next risk meeting.

The following four critical areas of concern of been identified

1.	2.	3.	4.
Trade and other receivables	Forward to buy shares in a major competitor	Loan Payable to American Supplier	Financial asset (bond) with returns linked to JIBAR(Johannesburg Interbank Agreed Rate)
Due to the nature of M&S's business activities, most customers cannot pay the cost of the restored collectible cars in cash. A strategy implemented to maintain competitiveness in the market is to offer credit terms. There is a strict credit policy and all customers are subject to review before credit is granted.	M&S is extremely risk adverse, especially because the industry they operate in suffers first when the economy does poorly. M&S has entered into a contract to buy shares in a major competitor at a future date to give them exposure to other companies and their approach to navigating the industry.	M&S is a popular brand and will do whatever it takes to promote the company and satisfy a customer. One customer, based in South Africa, found an American muscle car that he had always dreamed of owning. Unfortunately the car could only be sourced in America and M&S took out a loan, payable in US dollars, until the customer makes payment in South Africa.	In the past, M&S has earned exceptional returns on investments. In the current year they made a decision to maximise returns by purchasing a bond with a return of JIBAR +5%. The JIBAR is the benchmark rate commonly used in business dealings in South Africa

Additional Information:

- Ignore any tax consequences.
- Round all figures to the nearest round number.

QUESTION 3

(CONTINUED)

REQUIRED:

- a) Discuss the classification of the put option agreement by M&S to repurchase its own shares from Ruby Moon in the accounting records of M&S. (8)
- b) Prepare the journal entries to account for the put option agreement for the financial years ended 30 September 2013 **and** 30 September 2014 in the accounting records of M&S, if you assume that it should be classified as a derivative financial instrument. Your answer should include appropriate calculations. (8)
- c) Prepare the journal entries to account for the transaction with Traineacks for the financial year ended 30 September 2014 in the accounting records of M&S, **as far as the information available permits**. (17)

Journal narrations are not required; however your journals should clearly identify the month/period to which the journals relate as well as an indication of where the journal entry will flow to (P&L, OCI, SFP or SCE).

- d) Assist the risk committee by identifying and explaining the types of **financial risks**, in terms of IFRS 7 *Financial Instruments: Disclosure*, that each of the 4 items on the agenda, exposes M&S to. (7)

(40)

Show all calculations clearly as marks are awarded for them.