UNIVERSITY
OF
JOHANNESBURG

DEPARTMENT OF ACCOUNTANCY

ACCOUNTING 300 / BCTA

SUPPLEMENTARY ASSESSMENT OPPORTUNITY
4 DECEMBER 2014

THIS QUESTION PAPER MUST BE HANDED IN WITH YOUR ANSWER SCRIPT

ASSESSORS:	MR D DEYSEL
MODERATORS:	MS C HATTING MS K KEKANA
TIME:	4 HOURS
MARKS:	150

- THE ASSESSMENT OPPORTUNITY PAPER CONSISTS OF 3 QUESTIONS AND 9 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 **(60 MARKS)**

Haagen Lager Ltd (hereafter "H") is a company producing and selling not only alcoholic consumables but also production machinery used to produce various refined spirits. H is able to produce these products on a large scale due to its shareholding in other entities which assists in the group's supply chain.

GROUP INFORMATION

1. H purchased 80 000 shares in Amstel Ltd (hereafter "A") on 1 January 2012 when the retained earnings of A was R750 000. On that date an agreement was written with the other shareholders of A Ltd that H could acquire 80 000 of the A shares held by the other shareholders at any time. By year end H Ltd had not exercise this option. The direct equity interest and the option does however give H control, as defined in IFRS 10 *Consolidated Financial Statements*, over A.

2. Since acquisition of A, H has been selling its inventories to A, at a profit of 50% on cost. There was no opening inventory for such inventory in the books of A. A acquired all its inventory from H. Total sales for the current year is R1 000 000

3. A acquired 120 000 shares in Stella Artois (hereafter "SA") prior to 1 January 2012. SA Ltd produces triple distilled premium vodka which it sells to various wholesalers. On 1 January 2012 the retained earnings of SA was R825 000

4. On 2 January 2012 SA sold equipment with a carrying amount of R1 400 000, for R2 000 000 to A On that date the remaining useful life of the asset was 3 years. The equipment is also accounted for as equipment in the records of A.

5. On 1 January 2012 H acquired 120 000 shares of Smirnoff Ltd (hereafter "S"), another company producing a triple distilled vodka. The investment gives H significant influence over S. On 2 January 2012 S sold equipment to H, for a profit of R150 000. On that date the equipment had a remaining useful life of 4 years. The equipment is also treated as equipment in the books of H. At acquisition retained earnings of S was R1 000 000, the revaluation reserve was R150 000. On 1 January 2013 the balance for the revaluation reserve was R200 000.

6. The group uses the equity method to account for investments in associates. H accounts for non-controlling interest on the proportionate share of the net assets at acquisition.

7. The loan made by H to A incurs interest at a market related rate of 10%.

8. On 1 January 2013 H acquired a 40% interest in the ordinary share capital and the related shareholders' loan of Cloud Ltd (hereafter "C"). The loan carries interest at a market related interest rate of 11% p.a. and no transaction costs were incurred. C was classified as a joint operation in terms of IFRS 11 *Joint Arrangements*.

9. Assume a tax rate of 28%.

QUESTION 1 **(CONTINUED)**

EXRTRACT OF STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2013

	H	A	S	SA	C
Profit before taxation	1 372 000	976 000	680 000	1 310 000	137 000
Taxation	(630 000)	(600 000)	(240 000)	(500 000)	(38 360)
Profit after taxation	742 000	376 000	440 000	810 000	98 640

STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2013

Retained earnings	H	A	S	SA	C
Opening balance - (31/12/2012)	2 150 000	1 750 000	1 500 000	990 000	90 000
Net profit	742 000	376 000	440 000	810 000	98 640
Dividends paid/declared (31/12/2013)	(200 000)	(240 000)	(287 500)	(100 000)	(18 000)
Transfer to general reserve	(100 000)	-	-	-	-
Closing balance - (31/12/2013)	2 592 000	1 726 000	1 652 500	1 580 000	170 640

STATEMENTS OF FINANCIAL POSITION AT 31 DECEMBER 2013

	H	A	S	SA	C
ASSETS					
Property, plant and equipment	3 160 500	2 750 000	2 590 000	2 260 000	800 000
Investment in A	1 220 000		-	-	
Investment in S	430 000		-	-	
Investment in SA		300 000	-	-	
Loan to A	20 000				
Investment in C	280 000				
Loan to C	120 000				
Inventories	480 000	900 000	280 500	340 000	350 000
	6 452 000	3 680 000	2 870 500	2 600 000	1 150 000
EQUITY AND LIABILITIES					
Share capital – R1 shares	500 000	200 000	300 000	200 000	600 000
Replacement reserve	1 600 000	-	200 000	360 000	-
Retained earnings	2 592 000	1 726 000	1 652 500	1 580 000	170 640
Revaluation reserve	-	-	220 000	-	-
Current liabilities	500 000	-	-	-	79 360
Loan from shareholders	-	20 000	-	-	300 000
Shareholders for dividends	200 000	240 000	287 500	-	-
	6 452 000	3 680 000	2 870 000	2 600 000	1 150 000

QUESTION 1 **(CONTINUED)**

REQUIRED:

a) Provide all the pro forma journal entries to prepare the consolidated annual financial statements for the year ending 31 December 2013 for the Haagen Lager Group. Your journal entries need **NOT** include any allocation of since acquisition retained earnings / profit for the year to the non-controlling interest. (60)

(60)

QUESTION 2 **(50 MARKS)**

Extraction Ltd (hereafter "Extraction") is a JSE-listed company mining and processing vanadium ore on the Bushveld Complex in South Africa. Vanadium is applied in, among others, high-strength steels, high capacity energy storage and robotics. Vanadium ore is extracted through opencast mining that is a surface mining technique which 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 transactions during the financial year ended **28 February 2014**:

1. 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 800 mine workers. Basic salaries per month are paid in cash on the 25th of each month.

Due to the wage increase, the production costs to fulfil a particular long-term supply contract that Extraction has entered into have increased above the contracted selling price. The supply contract was signed on 1 September 2012 for a 24-month period. The total contract selling price was R5 million per month. As at 31 August the total estimated production cost per month to fulfil the contract, after the wage increase, amounted to R5.5 million. The effect of discounting for a period of 12 months or less is immaterial. The penalty to cancel the contract at any point in time amounts to R10 million. Any liability that arise due to this contract at 28 February 2014 should be presented as part of "Trade and other payables" on the face of the statement of financial position.

2. Power purchase agreement

On 1 March 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 R10 000 000 per year, payable on 28 February each year for five years. The lease payments increase with 10% every year. 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 R40 million. Extraction will also use the power generator for the majority of its economic life.

Extraction interprets "substantial" as referred to in IFRS as 90% or more. Extraction can borrow funds for 5 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 each payment as a deduction in the calculation of current taxation when paid in cash. SARS however does not allow any deduction for the power generator.

3. 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 (that is 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 and the insurance policy was transferred to the customer.

Revenue received in advance are 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 (Rnil as at 28 February 2012 and 2013).
- 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)	Identify the specialised IFRS standard that will be applicable to Extraction Ltd due to the nature of its operations. Also, provide a short description of the main features of this IFRS.	(5)
b)	Discuss the accounting treatment of the 10% wage increase and the resulting impact on the long-term supply contract (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 need not address presentation and disclosure.	(13)
	Communication Skills: Logical argument	(1)
c)	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.	(13)
	Communication Skills: Logical argument	(1)
d)	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 all 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**.	(17)
		(50)

QUESTION 3 **(40 MARKS)**

Agri Ltd ("Agri") is the leading listed South African agricultural services company that offers a wide range of services, skills and expertise.

The draft statement of comprehensive income for the financial year ended 30 June 20x1 is as follows:

Statement of Profit or Loss and Other Comprehensive Income of Agri Ltd Group for the year ended 30 June 20x1	
	R
Revenue	8,780,429.00
Cost of sales	(6,327,869.00)
Gross profit	2,452,560.00
Other operating income	118,785.00
Operating expenses	(1,332,152.00)
Finance costs	(720,160.00)
Profit before tax	519,033.00
Income tax expense	(106,370.00)
PROFIT FOR THE YEAR	412,663.00
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	412,663.00

The following transactions have **NOT** been included in the draft statement of profit or loss and other comprehensive income provided above:

1. Agri **acquired** 500 000 Telecom Ltd ordinary shares on 2 August 20x0. Telecom Ltd is listed on the JSE Ltd and its shares are traded frequently. Telecom Ltd announced a dividend declaration of 50c per share on 31 July 20x0 and the LDR date was set at 15 August 2x0. As Agri will receive the dividend, it acquired the shares at a cum div price of R8.50, 50c representing the dividend per share declared. At the acquisition date, Agri paid R50 000 transaction costs in cash. At 30 June 20x1 the listed share price of 1 Telecom Ltd share amounted to R10 per share. Agri chose to measure the investment in shares at fair value with gains and losses due to changes in fair value recognised in other comprehensive income. Agri expects to recover the investment through dividend income. Dividend income is an exempt income for income tax purposes. SARS allows a deduction for the transaction costs when paid in cash.

2. On 1 October 20x0 Agri also **issued** 2 000 convertible debentures. The debentures have a three-year term, and are issued for cash at par with a face value of R2 500 per debenture. Interest is payable annually in arrears at a nominal annual interest rate of 10%. The outstanding capital of each debenture is convertible at the option of the holder at any time up to maturity into 250 Agri ordinary shares. In the event that the debentures are not converted the face value of R2 500 per debenture is repayable in cash on the third anniversary (30 September 20x3). When the debentures are issued, the prevailing market interest rate for similar debt without conversion options is 12%. No transaction costs were incurred upon issuing the debentures. Assume no temporary differences arise due to this transaction. Any interest expense should be presented as part of finance cost on the face of the statement of comprehensive income.

3. Agri also entered into a forward contract with a supplier on 1 December 20x0. Agri wishes to purchase 24 000 tons (24 000 000 kilograms) of white maize (grade 1) over a period of six months. The risk and rewards of the white maize passes to Agri on delivery date. The cost price per ton is determined with reference to the average white maize price for the month preceding the delivery date. The delivery dates, quantity per date and average price per ton for each delivery can be summarised as follows:

QUESTION 3 **(CONTINUED)**

Delivery date	Quantity delivered (tons)	Average price per ton for month preceding delivery
2 January 20x1	4 000	12.15
1 February 20x1	4 000	12.20
1 March 20x1	4 000	12.05
1 April 20x1	4 000	11.90
1 May 20x1	4 000	11.85
1 June 20x1	4 000	11.80

The forward contract does **NOT** fall within the scope of IAS 32, IAS 39 and IFRS 9 (i.e. it is not accounted for as a derivative).

At 30 June 20x1 16 200 tons of white maize has been sold by Agri to clients at an average selling price of R13.00 per ton. It is the company's accounting policy to assign cost to inventory using the first-in-first-out method (FIFO) method.

At 30 June 20x1 the quoted price of white maize unexpectedly dropped to R10.00 per ton. As a result the average selling price that Agri will be able to generate will amount to R11.00 per ton. Any write-down to net realisable value should be accounted for as operating expenses on the face of the statement of comprehensive income. SARS determined that they would only allow 25% of the any accounting write-off as a deduction for tax purposes every year.

The normal tax rate on companies amounts to 28% and the CGT rate amounts to 14%. All deferred tax assets may be recognised in full.

REQUIRED:

a) Prepare the statement of profit or loss and other comprehensive income for Agri Ltd for the year ended 30 June 20x1 based on the information provided. Comparatives are not required. Components of other comprehensive income need to be presented net of tax. Show **ALL** calculations as marks will be awarded for these. Round all amounts to the nearest Rand. (30)

b) Calculate the deferred tax balance as **at 30 June 20x1**, using the **balance sheet approach**, as it relates to the following items: (8)

- Investment in Telecom Ltd (point 1)
- Inventory of white maize (point 3)

Indicate clearly whether the resulting deferred tax for each item represents a deferred tax asset (DTA) or a deferred tax liability (DTL). Round all amounts to the nearest Rand.

Presentation: (2)

(40)