UNIVERSITY OF JOHANNESBURG

DEPARTMENT OF ACCOUNTANCY

(Kingsway and Soweto Campuses)

ACCOUNTING – 3B

REPLACEMENT LAST ASSESSMENT OPPORTUNITY
4 DECEMBER 2014

ASSESSORS:	MR G BARNES MS B MADIKIZELA MS Z PATEL MR J WESSELS
INTERNAL MODERATOR:	MS K HEATHCOTE
EXTERNAL MODERATOR:	MR G WALDING
TIME:	150 MINUTES
MARKS:	125

- THE FINAL ASSESSMENT OPPORTUNITY PAPER CONSISTS OF 4 QUESTIONS AND 11 PAGES (front page included).
- SILENT NON-PROGRAMMABLE CALCULATORS ARE ALLOWED.
- SHOW ALL CALCULATIONS.
- START EVERY NEW QUESTION AT THE TOP OF A PAGE.

Question paper must be handed back

QUESTION 1 **(20 MARKS)**
[24 MINUTES]

On 1 February 2013, Skiprite Ltd an international company that is a global leader in the retail industry has, as part of its global expansion strategy into Africa, acquired a 51% controlling interest in You-Save Ltd. The cost of the investment in You-Save Ltd was R51 000 paid in cash on that date. Skiprite Ltd elected to measure the non-controlling interest (NCI) at its proportionate share of You-Save Ltd's identifiable net assets. Skiprite Ltd recognised the equity investment in You-Save in its separate financial statements and recognised fair value adjustments in a mark-to-market reserve (other comprehensive income).

The carrying amount of equity of Skiprite Ltd on the various dates consists of the following:

	30 September 2013	**30 September 2014**
	R	**R**
Share Capital	400 000	400 000
Retained Earnings	190 000	590 000
	590 000	**990 000**

The carrying amount of equity of You-Save Ltd on the various dates consists of the following:

	1 February 2013	**30 September 2013**	**30 September 2014**
	R	**R**	**R**
Share Capital	100 000	100 000	100 000
Retained Earnings/(Losses)	(30 000)	30 000	150 000
	70 000	**130 000**	**250 000**

Assume that the identifiable assets acquired and the liabilities assumed are shown at their acquisition-date fair values, as determined in terms of IFRS 3 *Business Combinations,* except for a deferred tax asset that was **not** recognised for the carry forward of unused tax losses of R30 000. It is probable that sufficient future taxable profit will be available against which the unused tax losses can be utilised. The reporting period end is 30 September. Assume a tax rate of 30%.

REQUIRED:

a) Calculate the goodwill or gain on bargain purchase arising on the acquisition of You-Save Ltd on 1 February 2013. (7)

b) Prepare the following columns of the consolidated statement of changes in equity of Skiprite Ltd Group for the year ended 30 September 2014 as far as the information given allows it:
   a. Non-controlling interest and
   b. Retained earnings (13)

QUESTION 2 **(12 MARKS)**
[14 MINUTES]

Dark-Earth (Pty) Ltd has been showing increasingly poor operating results for the past few years and therefore the board of directors decided to liquidate the company. You are presented with the following balance sheet as at 30 June 2014:

	R
ASSETS	
Property at cost	1 000 000
Machinery	1 000 000
Patents at cost	250 000
Non-current assets	2 250 000
Current assets	1 750 000
Inventories	1 000 000
Receivables	750 000
Total assets	4 000 000
EQUITY AND LIABILITIES	
Share capital: Authorised and issued	
500 000 Ordinary shares of R1 each	500 000
250 000 8% Preference shares of R1 each	250 000
	750 000
Accumulated loss	(425 000)
	325 000
6% Debentures (secured by first mortage over property)	500 000
Current liabilities	3 175 000
Payables	2 175 000
Bank overdraft	1 000 000
Total equity and liabilities	4 000 000

ADDITIONAL INFORMATION:

1. The preference shareholders have a preferential right to capital. The preference dividend is three years in arrears and has not been provided yet.

2. Included in the payables balance is an amount of R175 000 which is payable to a competitor in terms of a court order for the unauthorised use of a patent. The company's own patents are obsolete.

3. The company's bankers refuse to provide additional funds, as the company was reorganised a few years ago in an attempt to improve the capital structure. This process had however not been successful.

QUESTION 2 (CONTINUED)

4. The board of directors decided to liquidate the company, which resulted in the following:

    1. The property was taken over by the debenture holders at a valuation of R1 400 000 as final settlement of amounts owing. The difference was immediately paid in cash.

    2. The patents were sold to a competitor for R25 000.

    3. The receivables book was sold, and R585 000 was realised.

    4. Other assets were auctioned and the following amounts were realised:

Machinery	R 450 000
Inventories	R 550 000

    Machinery had a cost of R1 700 000 and accumulated depreciation of R700 000.

    5. Overdue preference dividends were declared and paid.

    6. Creditors were prepared to accept R0,45 in the Rand.

    7. Liquidation costs amounted to R25 000.

REQUIRED:

Prepare the liquidation account in the ledger of Dark-Earth (Pty) Ltd in order to give effect to the liquidation of the company. (12)

QUESTION 3 **(45 MARKS)**
[54 MINUTES]

PART A **(30 MARKS)**
[36 MINUTES]

Hou-so-aan Ltd (a wholesaler) acquired a controlling interest in Sal-weer Ltd (a manufacturer) on 30 June 2012, when the latter's equity consisted of the following:

	R
Ordinary share capital (R1-shares)	1 000 000
8% Preference share capital (R1-shares)	1 000 000
Replacement reserves	100 000
Accumulated loss	300 000

Hou-so-aan Ltd's percentage interest in Sal-weer Ltd remained unchanged since 30 June 2012. Retained earnings at 1 July 2013 amounted to R20 000. Profit for the year ended 30 June 2014 amounted to R120 000. The fair value of the investments in Sal-weer Ltd is equal to the cost thereof. On 30 June 2012 Sal-weer Ltd declared a preference dividend. The dividend was paid to the shareholders that were registered on 15 July 2012. No ordinary dividend was declared or paid during the current reporting period.

The abridged financial statements of the two companies at 30 June 2014 are as follows:

STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 2014	**HOU-SO-AAN LTD**	**SAL-WEER LTD**
ASSETS		
Non-current assets – Property, plant and equipment	1 250 000	2 780 000
Investment in Sal-weer Ltd at fair value		
800 000 Ordinary shares of R1 each	575 000	-
400 000 8% Preference shares of R1 each	375 000	-
Current assets	1 200 000	700 000
Inventories	500 000	250 000
Trade receivables	450 000	450 000
Bank	250 000	-
Total assets	3 400 000	3 480 000
EQUITY AND LIABILITIES		
Attributable to equity holders of the parent		
Share capital		
Ordinary shares of R1 each	1 000 000	1 000 000
8% Preference shares of R1 each	500 000	1 000 000
Distributable reserves		
Replacement reserves	300 000	100 000
Retained earnings	1 200 000	140 000
Total equity	3 000 000	2 240 000
Long term loan	-	240 000
Current liabilities	400 000	1 000 000
Trade payables	400 000	680 000
Bank overdraft	-	320 000
Total equity and liabilities	3 400 000	3 480 000

QUESTION 3 (CONTINUED) **(45 MARKS)**
[54 MINUTES]

PART A **(30 MARKS)**
[36 MINUTES]

REQUIRED:

a) Present only the group statement of financial position of Hou-so-aan Ltd and its subsidiary at 30 June 2014 to comply with International Financial Reporting Standards (IFRS).

Comparative figures and notes are **not** required. (30)

(30)

QUESTION 3 (CONTINUED) **(45 MARKS)**
[54 MINUTES]

PART B **(15 MARKS)**
[18 MINUTES]

On 1 January 2013 D-Bent-R Ltd issued 100 000 12% debentures of R10 each for total proceeds of R1 000 000. The interest is payable annually in arrears. Each debenture is compulsory convertible into 4 ordinary shares on 1 January 2019. The market related interest rate for similar debentures without conversion rights is 10% per annum.

D-Bent-R Ltd's accounting policy states that all financial liabilities are subsequently measured at amortised cost, using the effective interest rate method.

One of D-Bent-R Ltd's accounting clerks performed a present value calculation of the debentures. The calculation was performed correctly as follows:

PMT = R120 000
N = 7
I = 11
FV = 0

Therefore PV = R810 028

REQUIRED:

a) Provide the journal entries (including cash transactions) required to account for the issue of the debentures in the records of D-Bent-R Ltd for the year ended 31 December 2013. (7)

Notes:
- Show all calculations clearly, as marks will be awarded for them.
- Round all **final** calculated amounts off to the closest Rand.

b) Identify the following for accounting purposes as either being a financial asset **or** a financial liability, and provide the category under which it would fall:

i) Trade receivables
ii) Long term loan from ACB Bank
iii) Investment in municipal bonds with a fixed maturity date. (4)

c) Motivate why the following are **not** classified as financial assets or financial liabilities:

i) Provision for bad debts
ii) Finance lease vehicles
iii) Tax Payable (SARS) (4)

(15)

QUESTION 4 **(48 MARKS)**
[58 MINUTES]

PART A **(40 MARKS)**

Glitz Ltd is a company that specialises in home decor accessories. Glitz Ltd recently decided to incorporate a window accessories division in order to enhance their market share. For these purposes Glitz Ltd obtained a 70% interest (315 000 ordinary shares) in Extreme Curtains Ltd on 30 September 2010.

On that date the equity of Extreme Curtains Ltd was as follows:

	R
Share capital	450 000
Replacement reserve	50 000
Retained earnings	100 000
	600 000

During the current financial year, Glitz Ltd's board of directors decided to obtain a further 45 000 additional ordinary shares from the other shareholders of Extreme Curtains Ltd. Glitz Ltd paid R2,00 per ordinary share on 1 February 2013 to obtain the additional interest.

The abridged financial statements of Glitz Ltd and Extreme Curtains Ltd for the financial year ended 30 September 2013 are presented to you:

STATEMENTS OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2013		
	Glitz Ltd	**Extreme Curtains Ltd**
ASSETS	**R**	**R**
Land	230 000	320 000
Buildings	260 000	330 000
Machinery and equipment	247 250	260 000
Investment in Extreme Curtains Ltd at cost price	562 500	-
Current assets	680 250	515 000
Inventory	580 000	400 000
Receivables	100 250	80 000
Bank	-	35 000
	1 980 000	1 425 000
EQUITY AND LIABILITIES		
Share capital (Ordinary R1-shares) (unchanged since incorporation)	500 000	450 000
Replacement reserve	230 000	110 000
Retained earnings	687 800	340 000
Share capital and reserves	1 417 800	900 000
Long-term liabilities	220 000	220 000
Current liabilities	342 200	305 000
Payables	220 000	297 500
STC payable	6 500	7 500
Bank overdraft	115 700	-
	1 980 000	1 425 000

QUESTION 4 (CONTINUED)

STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 2013		
	R	**R**
Sales	5 000 000	600 000
Cost of sales	(2 000 000)	(160 000)
Gross profit	3 000 000	440 000
Expenses	(1 875 000)	(20 000)
Dividend income from Extreme Curtains Ltd	48 000	-
Profit before taxation	1 173 000	420 000
Income tax expense	(452 200)	(180 000)
Profit for the period	720 500	232 500

STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 SEPTEMBER 2013		
	Retained earnings	
	Glitz Ltd	**Extreme Curtains Ltd**
Opening balance – 1 October 2012	97 000	186 000
Profit for the period	720 500	232 500
Transfer to replacement reserve	(30 000)	(20 000)
Ordinary dividend paid – 30 September 2013	(100 000)	(60 000)
Closing balance – 30 September 2013	687 800	340 000

The following transactions took place between Glitz Ltd and Extreme Curtains Ltd:

1. Extreme Curtains Ltd sold inventory to Glitz Ltd since date of acquisition at a profit margin of 40% on cost price.

   Extreme Curtains Ltd sold inventories worth R2 000 000 (cost price plus 40%) to Glitz Ltd during the reporting period ended 30 September 2012. R315 000 (cost price for Glitz Ltd) of these inventories were still on hand at 30 September 2012. These inventories were however sold early in the 2013 financial year to parties outside the group.

   Glitz Ltd however didn't purchase any inventory from Extreme Curtains Ltd during the 2013 financial year, as Glitz Ltd acquired a machine and started with the production of curtains on their own.

   The process was however not as effective as Glitz Ltd hoped for and purchases of inventories from Extreme Curtains Ltd will be taken up again in the 2014 financial year.

2. Glitz Ltd however sold the manufacturing machine shortly before year-end to Extreme Curtains Ltd which they will use it in their production of curtains. On the date of sale the machine had a carrying value of R120 000 in the individual records of Glitz Ltd. The machine was sold to Extreme Curtains Ltd on 31 August 2013 for R150 000.

   On this date the machine had a remaining useful life of two and a half years.

QUESTION 4 (CONTINUED)

ADDITIONAL INFORMATION:

1. Goodwill arising from any business combination is accounted for in accordance with IFRS 3 *Business Combinations*.

2. Assume an income tax rate (that remained constant over the period) of 28%.

3. All income and expenses of Extreme Curtains Ltd accrued evenly, except for any unrealised inter-company profit.

   The income tax expense accrued evenly, except for the tax consequences of the inter-company transaction.

4. On the date of both acquisitions, the assets and liabilities of Extreme Curtains Ltd were deemed to be fairly valued.

5. The cost price of the investment of Glitz Ltd in Extreme Curtains Ltd is equal to the fair value thereof.

REQUIRED:

a) Prepare the pro-forma consolidation journal entries for the year ended 30 September 2013 that relate to the inter-company transactions between Glitz Ltd and Extreme Curtains Ltd.

   Note: Journal narrations are **not** required. (10)

b) Provide the pro-forma consolidation journal entries at 30 September 2013 to consolidate **Extreme Curtains** into the Glitz Group. Do **not** journalise inter-company transactions again.

   <u>Note:</u> Narrations and correct statement references must be provided. (20)
   Show all calculations with regards to the further acquisition.

c) Calculate the following amounts as they should appear in the consolidated financial statements of Glitz Ltd for the reporting period ended 30 September 2013:

   (i) Non-controlling interest in the consolidated statement of comprehensive income.
   (ii) Reconciliation of replacement reserve, from opening balance to closing balance in the consolidated statement of changes in equity.
   (iii) Non-controlling interest in the consolidated statement of financial position.
   (iv) Goodwill (if applicable). (6)

d) **Discuss** how your part (c) (i) and (iii) above would differ if Glitz Ltd **sold** a part of its interest in Extreme Curtains Ltd to non-controlling interest shareholders on 1 February 2013, resulting in Glitz Ltd's percentage interest in Extreme Curtains Ltd to be 48% after the sale.(4)

PART B **(8 MARKS)**
[10 MINUTES]

Assume for this part of the question only that the financial director of Glitz Ltd inspected the statement of financial position of Extreme Curtains Ltd before the acquisition and noted that the fair value of the entity's receivables was lower than its carrying amount. As a result, he proposed that upon initial recognition of the acquisition in the separate financial statements of Glitz Ltd, the receivables amount should be recognised at its carrying amount as this would reflect more favourably on the entity's current ratio.

REQUIRED:

Discuss whether the accounting treatment proposed by the financial director pertaining to the receivables balance is in line with the requirements of IFRS and can be considered to be ethical. Provide reasons for your answer in terms of the requirements of *IFRS 3 Business Combinations* as well as the objective of general purpose financial reporting, as outlined in the Conceptual *Framework.* . (8)

(48)