UNIVERSITY OF JOHANNESBURG

Department of Commercial Accounting

Financial Accounting 3A

SUBJECT CODE: FAC33A3/FAC3AA3

Supplementary Assessment Opportunity 2016

Date: July 2016

Time: 180 minutes **Marks: 100**

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INSTRUCTIONS:
This paper consists of 11 pages (including the cover page).
Answer all questions. **Show all calculations and workings clearly.**
Start each question on a new page in your answer book.
Silent, non-programmable calculators may be used.
Where applicable, round all calculations to the nearest Rand.

Question	Topic	Marks	Time
1	Theory	15	27 minutes
2	Leases	21	38 minutes
3	Property, Plant and Equipment & Borrowing costs	34	61 minutes
4	Financial Instruments	18	32 minutes
5	Intangible Assets	12	22 minutes
		100	**180 minutes**

<u>Question 1</u> **(15 marks)**

Multiple choice: Please select the most appropriate answer

1.1 On 1 January 2015 an entity provides an employee with a four-year interest-free loan of R1,000. The market rate that would be charged on a similar loan is 8 per cent per year. At what amount is the loan measured on initial recognition and how much interest income is recognised for the reporting period ended 31 December 2015? **(2)**

(a) On 1 January 2015 the loan is measured at R735.03. Interest income for the reporting period ended 31 December 2015 is R0 in 2015.

(b) On 1 January 2015 the loan is measured at R735.03. Interest income for the reporting period ended 31 December 2015 is R58.80 in 2015.

(c) On 1 January 2015 the loan is measured at R1,000. Interest income for the reporting period ended 31 December 2015 is R0 in 2015.

(d) On 1 January 20X1 the loan is measured at R1,000. Interest income for the reporting period ended 31 December 2015 is R80 in 2015.

1.2 Which of the following items in an entity's statement of financial position is a financial asset or financial liability within the scope of Section 11? **(1)**

(a) a liability for an amount due to a supplier for a past receipt of goods.

(b) an asset for a prepayment made to a supplier for the rent of a machine for two months.

(c) a liability for a fine for the late payment of income tax by the entity.

(d) all of the above.

1.3 A bank provides an entity with a five-year loan for R10,000 with fixed interest payable annually in arrears at a rate of 6 per cent of the principal amount. 6 per cent is considered to be the market rate for a similar five-year loan with interest payable annually in arrears. The bank charges the entity a fee of R50 for paperwork. At what amount should the entity measure the loan on initial recognition? **(2)**

(a) R9,384.

(b) R9,484.

(c) R9,950.

(d) R10,000.

(e) R10,050.

1.4 Which of the following financial assets is not in the scope of Section 11? **(1)**

(a) Cash.

(b) Trade receivables.

(c) A 5 per cent holding in the non-puttable ordinary shares of another entity (investee).

(d) A 30 per cent holding in the non-puttable ordinary shares of another entity (investee) where the investee is classified as an associate of the entity.

1.5 On 1 January 2015 an entity acquired a building for R100,000. At 31 December 2015 management:

- Assessed the building's useful life as 40 years from the date of acquisition
- Assessed the building's residual value as R20,000
- Assessed the entity will consume the building's future economic benefits evenly over 40 years from the date of acquisition
- Assessed the fair value of the building at R130,000.

The building is occupied by the entity's sales staff. **(2)**

The entity should measure the carrying amount of the building on 31 December 2015 at:

(a) R100,000

(b) R98,000

(c) R130,000

(d) R127,250

1.6 An entity operates an executive aviation service. The entity's only item of property, plant and equipment is an aircraft that it acquired for R10,400,000. The cost of the aircraft is attributed to its significant parts as follows: the jet engine (60%), body (20%), aviation equipment (10%) and furniture and fittings (10%). A condition of operating an aircraft is that it is inspected by the aviation authorities every three years. An inspection costs R400,000. The jet had been inspected at the manufacturer's expense before delivery to the entity. Aviation regulations require the jet engine to be replaced when it has flown 2,000,000 air miles. Management intends fitting a new engine to the aircraft when it requires replacement so that the aircraft can be used for approximately 10 years, at which time it intends to scrap the aircraft. Management does not expect to replace the body of the aircraft or the aviation equipment. However, management assessed the useful life of the furniture and fittings as five years at which time they will be scrapped and replaced. What is the cost of each of the significant parts of the aircraft that the entity must depreciate separately: **(2)**

(a) R6,240,000 jet engine, R2,080,000 body, R1,040,000 aviation equipment and R1,040,000 furniture and fittings.

(b) R10,400,000 jet aircraft.

(c) R6,000,000 jet engine, R3,000,000 body and aviation equipment, R1,000,000 furniture and fittings and R400,000 aviation inspection.

1.7 Which qualitative characteristics are fundamental to general purpose financial information? **(1)**

(a) relevance and reliability
(b) relevance and comparability
(c) reliability and comparability
(d) prudence and comparability

1.8 Materiality depends on: **(1)**

(a) the size of the item
(b) the nature of the item
(c) the size and nature of the item or error judged in the particular circumstances

1.9 Which of the following is not an element for which there is a concept in Section 2 of IFRS for SMES's? **(1)**

(a) Asset
(b) Liability
(c) Income
(d) Expense
(e) Other comprehensive income

1.10 Which of the following satisfies the definition of a liability? **(2)**

(a) The income generating capacity of a snow ski resort is greatly influenced by the amount of snowfall. Snowfall is erratic. To reduce the volatility in its reported profit, a snow ski resort would like to recognise a liability (and corresponding expense) in years of high snowfall (a provision for warm weather) and release that provision to income in years of low snowfall.

(b) An entity 'self insures' its assets against loss or damage, ie it opens a separate bank account (in the company's name) into which it transfers each month an amount equal to the market rate for damage/loss insurance cover. When the entity suffers damage or loss it uses the money in the separate bank account to restore or replace the damaged or lost item. To reduce volatility in its reported profit, the entity would like to recognise a liability (and corresponding expense) in the period in which it transfers cash into the separate bank account (a provision for self insurance) and decrease that provision when cash is paid out of the separate bank account to replace or restore a damaged or lost item.

(c) An entity is being sued for allegedly breaching the patent of one of its competitors. The entity's legal counsel believes that it to be more likely than not that the entity will lose the case.
(d) All of the above (ie (a) to (c))
(e) None of the above

Question 2 **(21 marks)**

Note 1:
On 1 January 2016 Adam Ltd entered into a five-year non-cancellable lease agreement, as lessee. The equipment that is being leased has an economic life of 7 years, at the end of which it is expected to have no value. At the beginning of the lease, the fair value of the equipment is R250,000. On 31 December for each of the first four years of the lease term, Adam Ltd is required to pay the lessor R63,000. At the end of the lease term ownership of the equipment passes to the lessee upon payment of the final lease payment of R70, 000.
The interest rate implicit in the lease is 10% per year.

Note 2:
Adam Ltd also entered into another lease where it leases a building under a 20-year operating lease. The lessor gave Adam Ltd a rent-free period for the first three years as an incentive to the lessee for entering the lease. The lease payments are fixed at R10 000 per annum for the lease period

REQUIRED:

2.1 How would you classify the arrangement in Note 1? (1)

2.2 Based on your answer in 2.1, provide reasons for your answer. (4)

2.3 How would you prove or confirm that at the inception of the lease the present value of the minimum lease payments amounts to substantially all of the fair value of the leased asset? Show workings. (4)

2.4 Assuming that the lease is a finance lease, prepare journal entries for the year ended 31 December 2016 relating to Note 1. Ignore the journal entry recognising the asset and the liability at initial recognition. (5)

2.5 Prepare journal entries for the year ended 31 December 2018 and 2019 relating to Note 2. (7)

[21]

<u>Question 3</u> **(34 Marks)**

Gainz (Pty) Ltd (Gainz) is a pharmaceutical company with a 31 December reporting date. The directors have requested your assistance in how to deal with a couple of their assets.

<u>Factories</u>
On 1 October 2014, a conversion began on one of the factories so that it could produce a new type of drug. During the conversion, the factory was not available for use.

The factory had cost R800 000 (excl. VAT).

It was initially available for use on 1 March 2012 but was only brought into use on 1 July 2012.

The carrying amount of the factory on 1 January 2014 was R575 000.

The cost of the conversion came to R650 000 (excl. VAT) including set-up costs, and was completed on 31 December 2014. All of the conversion costs were paid in cash.

The new residual value on 31 December 2014 after the conversion was estimated to be R12 500 (excl. VAT) and the remaining useful life was four years.

Gainz took out a loan of R741 000 on 1 September 2014 in order to finance the conversion of the factory (a qualifying asset). Interest is charged at 10% per annum and payable annually on 31 December.

No portion of the loan or the related interest was paid by 31 December 2015.

<u>Vehicles</u>
Gainz has three delivery vans. They had each cost R256 500 (incl. VAT). Two of these were purchased and brought into use on 30 June 2014 and the third was purchased and brought into use on 1 January 2015.

Vehicles were depreciated on the straight line method over a useful life of five years with a R25 000 (excl. VAT) residual value.

On 1 January 2015 the directors re-assessed their estimates. Because of the new drug that's being produced, the depreciation method being used is no longer representative of how economic benefits are generated.

They have determined that the useful life of the vans is directly linked to the number of pills of the new drug that can be produced. The following numbers have been estimated by the production manager:

2015: 40 000 pills
2016: 55 000 pills
2017: 60 000 pills
2018: 45 000 pills

Additional information:

Gainz is a medium sized entity that has chosen to apply full International Financial Reporting Standards (IFRS). This includes their accounting for “Property, Plant & Equipment” and “Borrowing costs”.

REQUIRED:

3.1 Prepare the journal entries relating **only to the converted factory and the related loan** for Gainz (Pty) Ltd for the reporting periods ended 31 December 2014 and 31 December 2015. (21)
Journal narrations are not required.

3.2 Prepare **only the vehicles column** of the property, plant and equipment note for Gainz (Pty) Ltd for the reporting period ended 31 December 2015. (13)

Comparatives are required.

Ignore deferred tax implications for this question.

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Question 4 **(18 marks)**

An entity has the following amongst others in the trial balance for the reporting period ended 31 December 2015.

			Subsequent measurement under Section 11		
Balance	2015 R	In scope of Section 11?	Fair value	Amortised cost	Cost less impairment
Opening retained earnings	(1,961,353)				
Share capital (40,000 ordinary shares with par value CU1.00)	(40,000)				
Property, plant and equipment	2,349,945				
Intangible assets	850				
Inventory	57,381				
Trade receivables	565,548				
Cash on hand	13,980	Yes	Always measured at cash equivalent in functional currency.		
Investment in non-puttable ordinary shares in a listed company	4,740				
Investment in non-puttable non-convertible preference shares in an unlisted company	3,210				
Investment in fixed interest fixed term bonds	5,180				
Deposit at bank (Fixed term. Fixed interest)	10,000				
Bank loans (Fixed term. Fixed interest)	(110,000)				

REQUIRED:

Complete the table above. Note which items are within the scope of Section 11 and, for those that are, whether they should be measured subsequent to initial recognition at fair value through profit or loss, amortised cost or cost less impairment. **[18]**

Question 5 **(12 marks)**

5.1 According to IFRS for SMEs, when is an intangible assets considered to be identifiable? (4)

5.2 On 1 January 2016 an entity acquired computer software to operate one of its specialised machinery for R1 000 000. Included in the R1 000 000 is R50 000 refundable purchase taxes and R50 000 non-refundable taxes. In January 2016 the entity incurred the following costs to get the software in a condition more suited to the systems used by the entity:

- Labour costs of R150 000
- Depreciation of plant and equipment used to perform the modifications – R100 000. The same plant and equipment is used for administrative purposes. 40% of the depreciation is directly attributable to the modifications of the software.
- Labour for training staff R30 000.
- Administration costs of R10 000
- The computer software was tested for functionality on the 1 March 2016. The testing costs were R20 000. The computer software was available for use immediately after testing however the entity only started using it on the 14 April 2016.

What is the cost of the computer software as above? (6)

5.3 Calculate the amortization expense for the year ended 31 December 2016 assuming the software has a useful life of four years. (2)

Total: 100

PRESENT VALUE TABLE

PRESENT VALUE OF R1

PERIOD	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
1	0,952	0,943	0,935	0,926	0,917	0,909	0,901	0,893	0,885	0,877	0,870
2	0,907	0,890	0,873	0,857	0,842	0,826	0,812	0,797	0,783	0,769	0,756
3	0,864	0,840	0,816	0,794	0,772	0,751	0,731	0,712	0,693	0,675	0,658
4	0,823	0,792	0,763	0,735	0,708	0,683	0,659	0,636	0,613	0,592	0,572
5	0,784	0,747	0,713	0,681	0,650	0,621	0,593	0,567	0,543	0,519	0,497
6	0,746	0,705	0,666	0,630	0,596	0,564	0,535	0,507	0,480	0,456	0,432
7	0,711	0,665	0,623	0,583	0,547	0,513	0,482	0,452	0,425	0,400	0,376
8	0,677	0,627	0,582	0,540	0,502	0,467	0,434	0,404	0,376	0,351	0,327
9	0,645	0,592	0,544	0,500	0,460	0,424	0,391	0,361	0,333	0,308	0,284
10	0,614	0,558	0,508	0,463	0,422	0,386	0,352	0,322	0,295	0,270	0,247