Accountancy@UJ

UNIVERSITY OF JOHANNESBURG

ADVANCED ACCOUNTING

FINAL ASSESSMENT OPPORTUNITY

NOVEMBER 2018

FIRST EXAMINER:	MR. M VAN WYK	**TIME:**	225 MINUTES
INTERNAL MODERATOR:	PROF. D. COETSEE	**MARKS:**	150 MARKS
EXTERNAL MODERATOR:	MR. L STEYN		

INSTRUCTIONS:

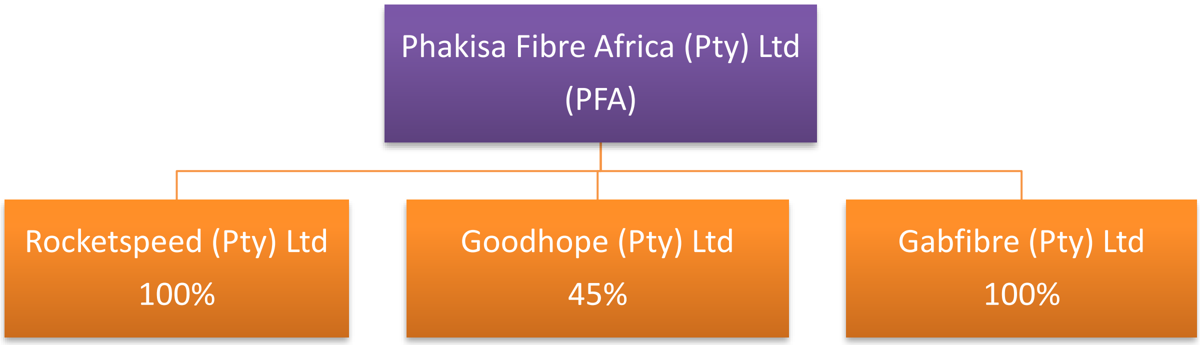
1. This paper consists of ten (10) pages. If your paper does not contain all the pages, please put up your hand so that a replacement paper can be handed to you.
2. Answer all the questions.
3. You will have thirty (30) minutes of reading time. Thereafter you will have two-hundred and twenty five (225) minutes to answer the required section.
4. **No** calculators may be used during the reading time.
5. Calculate the time that you should spend on each question by multiplying the number of marks for each question by 1.5 to determine the time, in minutes, available for each question. Adhere to these time constraints in order to finish the paper in the given time.
6. Delete **all** open spaces on your answer sheets with pen. Pages on your answer sheets that contain open spaces will be marked as such and those pages will not be eligible for a remark.
7. No tippex or pencil may be used on your answer sheets. Pages on your answer sheets that contain pencil or tippex will be marked as such and will not be eligible for a remark.
8. All the examination regulations of the UJ and the policy document for students of the Department of Accountancy will apply during this assessment.
9. The neatness and presentation of your answers will be taken into account when marking your paper.
10. Please round off to the nearest Rand for all your calculations.

QUESTION-SCENARIO

Phakisa Fibre Africa (Pty) Ltd (PFA), is one of the premier open access fibre optic companies in South Africa, providing our clients with the infrastructure they need to run their businesses. Since 2007, PFA laid the foundations for fibre optics in South Africa. PFA offers a comprehensive spread of products to our clients. PFA leases their infrastructure fibre while also maintaining, building, installing, managing and financing of the fibre networks.

PFA is in the business of connecting their clients to their clients through fibre optic cables. Through services, they've aided and empowered large, medium and small businesses, enabling them to expand their infrastructure at minimal cost. These companies include conglomerates, telecoms operators, internet service providers and the general public. PFA's state-of-the-art network monitoring centre in Randburg, Johannesburg, provides round-the-clock monitoring to ensure that their network remains up and running 24/7.

The PFA Group ('the Group') consists of a number of subsidiaries and associate companies that are strategically placed to add value to the business. The following is an illustration of the group structure of the Group:



Rocketspeed (Pty) Ltd ('Rocketspeed') is the main servicing business of the Group that provides the installations at the customers, sells Wi-Fi routers and provides unique data packages on a contract basis in the Johannesburg area. Goodhope (Pty) Ltd (Goodhope) is the Cape Town equivalent of Rocketspeed and is considered to be the fastest growing business segments. Gabfibre (Pty) Ltd (Gabfibre) a newly purchased subsidiary that gives the Group a footprint into Botswana.

You are the financial accountant of the Group and you are currently busy with the preparation of the financial reporting pack for the annual audit. The CFO, Mr Jackson Kolisi, requested your assistance on certain financial matters that will affect the financial statements for the reporting period ended 30 September 2018. These matters are included in the mails below:

Email number	Subject
Email 1	Lease agreements
Email 2	Revenue contracts in Rocketspeed
Email 3	BEE Share Schemes
Email 4	Financial Contracts
Email 5	Gabfibre (Botswana)
Email 6	Additional interest in Goodhope

EMAIL 1 **38 MARKS**

To: accountant@pfa.co.za
From: jkolisi@pfa.co.za
Date: 25 October 2018
Subject: Lease agreements in PFA

Dear accountant

Please find below the summarised information regarding three lease agreements that we have in PFA. Please review them as soon as possible and get back to me on the specific questions on each agreement.

Kind regards, Jackson

Telecon Agreement

PFA enters into a five-year contract with Telecon, a telecommunications utilities company, for the right to use five specified, physically distinct dark fibres within a larger cable connecting Johannesburg to Soweto.

PFA has the ability to make the decisions about the use of the fibres by connecting each end of the fibres to its data providing equipment. Basically, PFA initiates ('lights') the fibres and decides what data, how much data and the timing of the data those fibres will accommodate on the line. These rights are limited to the fibre line from Johannesburg to Soweto and nothing more.

Telecom is responsible for the repairs and maintenance if there are any damages or outages on the fibres within the cables. Telecom can substitute the fibres within the fibre cable only on the basis that those fibres require repairs. Telecon has no other right to substitute the fibres through the duration of the contract.

We are not sure if this is in fact a lease in the scope of IFRS 16.

Lease of office building

On 30 September 2016, PFA entered into a ten-year lease of the office building in Randburg with an option to extend the lease for a further two years. At the commencement of the lease, PFA concluded that it was not reasonably certain at that stage whether they will exercise the option to extend the lease. The following summarised information regarding the lease has been provided to you below.

- The lease payments are R400 000 per year during the initial lease term and R600 000 per year during the optional period, all payable at the end of each year.

- The VAT was not financed as part of the lease and therefore all the lease payments excludes VAT

- The ownership of the asset is not transferred to PFA at the end of the lease term.

PLEASE REFER TO THE NEXT PAGE FOR THE REST OF THE INFROMATION

- The interest rate implicit in the lease is 11.55%. PFA's incremental borrowing rate is 11.80% per annum which reflects the equivalent risk on future borrowings by PFA.

The junior accountant provided the following correct amortisation schedule balances based on the original terms of the agreement (excluding the lease term extension) as at 1 October 2017 (one year into the lease).

Date	Payment	Capital	Interest	Closing balance
1 October 2016				2 302 337
30 September 2017	(400 000)	(134 080)	265 920	2 168 257

On 1 October 2017, PFA realised that the Randburg area is increasing significantly in economic activity and therefore had an economic incentive to extend the lease term by the additional two years. Management concluded on 1 October 2017, that it was reasonably certain that PFA will extend the lease with the additional two years. The rate implicit to the lease increased to 12.30% on 1 October 2017 based on the change in the lease term.

The right of use asset is depreciated on a straight line basis over the lease period as per the accounting policy of PFA. VAT implications can be ignored. The South African Revenue Services ('SARS') allows a 5% annual allowance on office buildings for income tax purposes.

Lease of facilities truck

On 30 September 2018 PFA leased a facilities truck to Jozi Networks (Pty) Ltd ('Jozi Networks'). The particulars of this lease contract are as follows:

- The truck was purchased by PFA on 28 September 2018 for R460 000 (incl VAT);
- The economic useful life of the truck is estimated to be 4 years;
- The lease term agreed upon is 4 years;
- The initial interest rate implicit in the lease is 13.50% and the incremental borrowing rate is 12.25%;
- The guaranteed payment at the end of the lease is R57 500 and the unguaranteed residual value is R23 000.
- The lease instalments are payable annually in arrears on 30 June of every year.

PFA uses the effective interest rate method for the apportionment of the finance income and depreciation is written off over 4 years on the straight-line method. SARS allows a wear and tear allowance of 20% per annum on the facilities truck. The allowance is not apportioned for parts of the year.

PFA uses the facilities truck for a qualifying purpose in terms of the VAT Act. The lease to Jozi Networks qualifies as an Instalment Credit Agreement for VAT purposes.

EMAIL 2 **30 MARKS**

To: accountant@pfa.co.za
From: jkolisi@pfa.co.za
Date: 25 October 2018
Subject: Revenue contract - Rocketspeed

Dear accountant

Please find below the summarised information regarding the revenue contract with King's College. The contract is very unique and the first of its kind, but there may be more to come as we move into the educational space. Will you please write a report on the treatment in terms of IFRS 15 *Revenue from Contracts with Customers* ('IFRS 15')?

Kind regards, Jackson

Rocketspeed entered into a 24-month contract with King's College ('the customer') on 1 September 2018 on a new unique bundle deal to provide data to the school to enhance their student experience with a drive for teaching and learning with technology. This contract is a valid contract in terms of IFRS 15. The summarised information of the promises in the contract is provided below:

Promise	**Additional detail**	**Stand-alone selling price (Excl. VAT)**
Installation services	The installation is to activate the line and to ensure that the line is working. The installation services are also usually provided separately if other service providers are not able to do installations on their own packages. However, the use of the fibre line and access to data depends significantly on the installation done upfront.	R 3 450
Indi 2.0 Wi-Fi router	The Indi 2.0 router is designed for large amount of data traffic and suitable for schools and businesses. The router comes out with a standard 24-month factory warranty for any factory defects that may arise during this period. The Indi 2.0 router can be replaced by the customer should the customer have a better suited router available at their premises.	R 4 600
Monthly data	The monthly data is uncapped and unshaped. The download speed is 1000mbps and the upload speed is 100mbps. This a very popular option under businesses and educational providers as it designed for heavy internet usage.	R9 100 per month R218 400 (24 months contract)

As part of this deal, the customer will be liable to pay R9 000 (Excl. VAT) per month for the duration of the 24-month period. The installation services and the router is free of charge if you take out this package deal. Rocketspeed will issue a monthly invoice that will be payable in advance via a debit-order against the bank account of the customer.

If there is any outstanding debt for an extended period of time, Rocketspeed charges a market related interest rate (adjusted for credit risk) of 11.55% to the outstanding debt of the customer. A general market related discount rate (excluding credit risk) is considered to be 10.50%.

EMAIL 3 **21 MARKS**

To: accountant@pfa.co.za
From: jkolisi@pfa.co.za
Date: 28 October 2018
Subject: BEE Share Scheme

Dear accountant

I need you to assist me on the accounting treatment for our BEE share scheme. I have included the details of the scheme below. The other accountants are unsure on how to treat the change in the strike price on 1 October 2017.

PFA also seeks clarity regarding purchase of land using a share based payment. PFA acquired land with a fair value of R1 000 000 from Sellit (Pty) Ltd on 1 December 2017. The purchase agreement state that PFA has choice of settlement of:

1. Payment in cash based on the fair value of PFA ordinary shares at settlement date or

2. Settlement through issuing of 500 000 R2 shares.

We are certain that the debit entry should be an asset. How should the credit entry be accounted for? We don't have any past practices regarding these type of transactions.

Kind regards, Jackson

BEE share scheme

The need for fibre and high speed data packages has grown exponentially in recent years. The board of directors of PFA decided to reward qualifying BEE employees through a BEE share scheme. The incentive scheme was implemented to assist in retaining key management staff in key positions within the company's operations.

In light of this, PFA issued 1 000 share options to each of the 50 key BEE employees on 1 October 2015 to acquire ordinary shares when vesting conditions are satisfied. The strike price of these options is R8.50 per share which is equal to the fair value of a PFA ordinary share on 1 October 2015. The employees will receive benefit of future growth of the share price. The share options vest on 30 September 2020 provided both of the following vesting conditions are satisfied:

Condition A: The employee has remained in the employment of PFA throughout the vesting period.

Condition B: The market price of PFA ordinary shares maintain a 15% growth until 30 September 2020.

The following estimated information has been provided to by management to indicate the number of BEE employees that are expected to leave during the vesting period.

Date of estimation	**Expected cumulative number of employees resigning during the vesting period**
30 September 2016	8 employees
30 September 2017	10 employees
30 September 2018	15 employees

The fair values of the options, calculated using the Black-Scholes Model, were determined as follows:

	Before adjusting for any of the vesting conditions	**After adjusting for the market conditions only**
	Rand	**Rand**
1 October 2015	12.35	14.10
30 September 2016	13.50	14.88
30 September 2017	1.25	2.55

In 2017, the South Africa suffered a credit downgrade to junk status and it negatively impacted the economy as a whole. PFA also struggled to reach their earnings targets. On 30 September 2017, the fair value of the share options was considered to be R1.25. PFA then decided to lower the strike price of the share options to R3.50. On 1 October 2017, immediately after the strike price was lowered, the fair value of the share options increased by R4.50.

EMAIL 4 **24 MARKS**

To: accountant@pfa.co.za
From: jkolisi@pfa.co.za
Date: 29 October 2018
Subject: Financial contracts

Dear accountant

Please find below the information regarding the Steelkor (SOC) Ltd debentures we purchased at the start of the year as well as the financing transaction with Outvestec Ltd. Willl you please assist us with the accounting treatment of both matters?

Kind regards, Jackson

Investment in Steelkor (SOC) Ltd

On 1 October 2017, PFA (Pty) purchased 1 000 000 R5 debentures in Steelkor (SOC) Ltd ('Steelkor'), a state-owned steel manufacturer, at a discount of 10%. A coupon rate of 12% per annum is payable in arrears on 30 September. The bonds will be redeemed on 30 September 2020 at a premium of 25%. Transaction costs paid by PFA amounted to R73 500. The investment in bonds is held within a business model whose objective is to collect contractual cash flows as PFA do not manage the earnings on a fair value basis. The market related interest rate before capitalisation of transaction costs was considered to be 13.55%.

On 1 October 2017, PFA assessed the probability that Steelkor will default on payments as low as 10% and that the estimated default for losses within 12 months (12-Month Expected Credit Losses) was R68 750. This amount of default loss was already adjusted for time value of money.

On 30 September 2018 there was a significant deterioration in the credit quality of Steelkor due to major strikes within the steel sector. PFA used an actuary to assist with the calculation of the credit losses expected over the life of the Steelkor debentures. The actuary has provided the following new information regarding the default expected in the Steelkor debentures:

Expected loss (adjusted for time value of money)	R nil	R1 889 500	R3 300 200
Probability of default to occur	30%	50%	20%

Expansion of business through preference shares.

On 3 October 2013 PFA issued 5 million R20 par value 7% preference shares at a premium of R3.50 per share. The preference shares are, at the option of the holder, convertible into ordinary shares (1 ordinary share for every 2 preference shares) on 30 September 2018. If the shareholder elects to receive cash at the end of the period, the preference shares will be redeemed at par on 30 September 2018. This was initially classified as a compound financial instrument in terms of IAS 32 *Presentation of Financial Statements.*

The opening balance on 1 October 2017, was R97 272 727. The balance was correctly extracted from the amortisation schedule of the preference shares. On 30 September 2018, 30% of the preference shareholders elected for conversion of the preference shares to ordinary shares and the remaining 70% were redeemed in cash. Preference dividends are declared at the end of each calendar year. The appropriate adjusted market rate for preference shares is 10% (before tax).

EMAIL 5 **20 MARKS**

To: accountant@pfa.co.za
From: jkolisi@pfa.co.za
Date: 29 October 2018
Subject: Gabfibre (Botswana)

Dear accountant

We have acquired Gabfibre (Pty) Ltd on 1 March 2017 in order to expand into Botswana. However, the accounting for the acquisition in terms of IFRS seems a bit tricky. Will you please review the information below and get back to me?

Kind regards, Jackson

Gabfibre consolidation

PFA purchased 100% of the ordinary shares in Gabfibre on 1 March 2017, thereby obtaining control over the company. Gabfibre is domiciled in Botswana and has the Botswana Pula (BWP) as its functional currency. The purchase consideration consists of R100 million cash and shares issued to Gabfibre to the value of R50 million. Gabfibre operates the fibre service and installation business in Botswana. PFA's intention was to actively pursue a new market into Southern Africa to provide fibre to communities that are in need.

On 1 March 2017 the net asset value of Gabfibre amounted to BWP80 million, comprising ordinary share capital of BWP20 million and retained earnings of BWP60 million. The previous group financial accountant was of the opinion that the net asset value was fairly stated in terms of IFRS 3 *Business Combinations*, with the exception of the following item where she was uncertain how it should be accounted for:

Gabfibre have developed a unique software license called an Electronic Communications Service (ECS) license. The license allow you to provide services to customers in Botswana over Botswana's network provider's network. The license can be transferred and sold to other 3rd parties even though this is not the intention of Gabfibre. The fair value value of the license software is BWP15 million on 1 March 2017. License has a useful life of 10 years and no tax allowance are deductible for income tax purposes.

The accountant provided the trial balance for the PFA group, which already consolidates the South African subsidiaries but excludes the consolidation of Gabfibre.

	Extracts from the PFA group consolidated trial balance, excluding consolidation of Gabfibre	**Gabfibre**
	R'000	**BWP'000**
Retained earnings at the beginning of the year	8 210 000	90 000
Profit after tax (accrued evenly in the year)	725 000	45 000
Dividends declared and paid on 30 June 2018	(80 000)	(10 000)

The following exchange rates are applicable to convert Botswana Pula into Rands:

	Spot Rate	**Average rate**
	BWP:ZAR	**BWP:ZAR**
1 March 2017	1,220	–
1 March 2017 to 30 September 2017	–	1,225
30 September 2017	1,253	–
30 June 2018	1,260	–
1 October 2017 to 30 September 2018	–	1,270
30 September 2018	1,280	–

Additional Information

- The Botswana corporate income tax is a single flat rate of 22%.
- Investments in subsidiary companies are accounted for at cost in the separate financial statements of PFA in terms of IAS 27 *Separate Financial Statements.* There were no reserves or movements in equity other than those included in the scenario above.

EMAIL 6 **17 MARKS**

To: accountant@pfa.co.za
From: jkolisi@pfa.co.za
Date: 29 October 2018
Subject: Additional interest in Goodhope

Dear accountant

As you know we originally had a 45% interests in Goodhope (Pty) Ltd ('Goodhope'). The company is a medium sized company and is not listed on the JSE. Goodhope is considering to move their reporting framework to IFRS for SMEs.

Due to good growth the Cape region is showing, we decided to purchase another 25% of the ordinary shares to obtain control over Goodhope as from 1 September 2018. The junior accountant has provided the following journal entry to calculate the gain from bargain purchase from the business combination in terms of IFRS 3 *Business Combinations* in the consolidated*:*

Dr Share Capital	100 000	
Dr Retained Earnings	12 325 667	
Cr Bank		3 000 000
Cr Liability		5 000 000
Cr Non-controlling interest		3 727 700
Cr Gain from Bargain Purchase (P/L)		697 967

The following information is relevant to the journal entry of the junior accountant above:

1. The issued share capital of Goodhope was R100 000 and the retained earnings was R12 325 667 on 1 September 2018.
2. The purchase consideration to obtain control over Goodhope were as follows:
   - A cash amount of R3 000 000 paid on 1 September 2018.
   - An additional cash amount of R5 000 000 payable 12 months after control was obtained (31 August 2019). The market related discount rate for similar liabilities is considered to be 10.88%.
3. Non-controlling interest is measured at the proportionate share of the identifiable net assets in Goodhope.
4. The fair value of the previously owned interest (45%) was R3 600 000 on 1 September 2018.
5. On 1 September 2018, Goodhope had a contingent liability disclosed in their financial statements for which it had a present obligation based on a claim through a court order. However, the probability of outflow was considered to be very low (10%) due to some complexities with regards to how the liability will be settled. The total amount of the claim was estimated to fairly valued at R10 000 000. This claim is capital in nature and therefore not deductible for income tax purposes. This contingent liability was ignored in the journal from the junior accountant.
6. A piece of land with a cost price of R5 325 000 was included in the net assets of Goodhope on 1 September 2018. However, a valuation expert has valued the property on 10 September 2018 at a fair value of R6 820 000. The expert mentioned that this value should not be materially different from a fair value on 1 September 2018.

UNIVERSITY OF JOHANNESBURG

ADVANCED ACCOUNTING
FINAL ASSESSMENT OPPORTUNITY – REQUIRED

QUESTION 1 **150 MARKS (225 MINUTES)**

	EMAIL 1	**MARKS**
a)	Discuss whether the agreement to use the fibre provided by Telecon contains a lease in terms of IFRS 16 *Leases* in the accounting record of PFA (Pty) Ltd for the reporting period ended 30 September 2018.	**(8)**
b)	Provide the relevant journal entries relating to the lease of the office building in the accounting records of PFA (Pty) Ltd for the reporting period ended 30 September 2018. • Ignore all VAT Implications • Show all calculations clearly • Deferred tax should be calculated using the balance sheet method	**(16)**
c)	Provide the relevant journal entries relating to the lease of the facilities truck to Jozi Networks (Pty) Ltd in the accounting records of PFA (Pty) Ltd for the reporting period ended 30 September 2018. • Show all calculations clearly • Deferred tax should be calculated using the balance sheet method	**(14)**
	EMAIL 2	
d)	Discuss the recognition and measurement of revenue from the King's College contract in the financial statements of Rocketspeed (Pty) Ltd for the reporting period ended 30 September 2018 in terms of IFRS 15 *Revenue from Contracts with Customers* (IFRS 15). You may assume that this is a valid contract in terms of IFRS 15. Mark are allocated to the following steps: • Step 2 (11) • Step 3 (7) • Step 4 (5) • Step 5 (6) • Communication and logical argument (1)	**(30)**
	EMAIL 3	
e)	Discuss how the credit entry of the acquisition of land will be classified in terms of the *Conceptual Framework* in the financial statements of PFA (Pty) Ltd for the reporting period ended 30 September 2018.	**(7)**

f)	Journalise the transactions (including deferred tax) relating to the share incentive scheme in the accounting records of PFA (Pty) Ltd for the reporting period ended 30 September 2018.	**(14)**
	EMAIL 4	
g)	Provide all the relevant journal entries to account for the investment in Steelkor (SOC) Ltd debentures in the financial statements of PFA (Pty) Ltd for the reporting period ended 30 September 2018. **Please note:** • Ignore VAT and deferred tax implications	**(14)**
h)	**Briefly discuss** whether you agree that the initial classification of the preference shares was a compound instrument **and journalise** the transactions for the reporting period ended 30 September 2018 in the financial statements of PFA (Pty) Ltd. **Please note:** • There is no need to follow the state, define, apply and conclude method in your discussion.	**(10)**
	EMAIL 5	
i)	Present the consolidated statement of changes in equity for the PFA Group for the reporting period ended 30 September 2018 to consolidated Gabfibre (Pty) Ltd. **Please note** • Show all calculations in your analysis clearly. • Assume that there is no deferred tax consequences on FCTR.	**(20)**
	EMAIL 6	
j)	**Critically review** the journal provided by the junior accountant to account for the acquisition of Goodhope (Pty) Ltd on 1 September 2018 in order to identify and discuss any non-compliance with IFRS 3 *Business Combinations*. Your answer should be answered **in table format** by identifying the non-compliance and briefly explaining the non-compliance by referring to the correct requirements of IFRS 3.	**(10)**
k)	Discuss whether Goodhope (Pty) Ltd may be able to apply IFRS for SME's based on the requirements in Section 1 of the IFRS for SME's standard.	**(7)**

"It always seems impossible until it's done" – Nelson Mandela

PLEASE NOTE:

Start each question on a new sheet.

Show all your calculations clearly since marks are awarded for calculations.