Accountancy@UJ

UNIVERSITY OF JOHANNESBURG

ADVANCED ACCOUNTING

FINAL ASSESSMENT OPPORTUNITY

JANUARY 2019

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 nine (9) 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. Round off all your calculations to the nearest Rand.

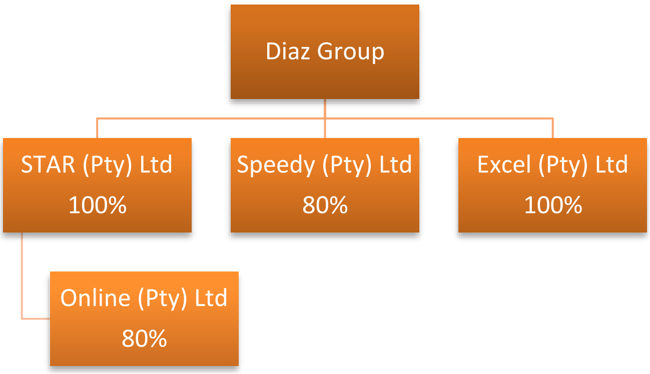
QUESTION - SCENARIO

Diaz Group (Pty) Ltd ('Diaz') is one of South Africa's leading retailer in electronic equipment for home and office use, adding value to the lives of people using electronics. With a vision to provide value to the customers, Diaz is renowned for their wonderful customer service and great value deals in a regular basis.

Diaz has growth vigorously since the company was started in 2009. The company currently has over 100 stores across South Africa, including a newly introduced online platform. The company also has a distribution facility in Bloemfontein to deliver their sold products from their online platform.

Diaz aims to list on the Johannesburg Stock Exchange within the next five years. As part growing the company, Diaz is also targeting expansion into neighbouring Southern African countries. This is expected to have a significant impact on sales growth.

The Diaz 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 Diaz Group:



STAR (Pty) Ltd ('STAR') is the main retailing store chain for the Diaz Group most of the revenue is generated from STAR. Speedy (Pty) Ltd (Speedy) is the groups own courier-company and manages the distribution of sold products to customers. Excel (Pty) Ltd ('Excel') deals with all investment activities in the group, including investment properties and broad range financial instruments.

You are the Financial Manager of the Diaz Group and you are currently busy with the preparation of the financial reporting pack for the annual audit. The CFO, Ms Sisulu, requested your assistance on certain financial matters that will affect the financial statements for the reporting period ended 31 December 2017.

PART 1 **20 MARKS**

On 1 July 2017, STAR acquired a 80% controlling interest in Online (Pty) Ltd ('Online'). The reason for this acquisition was to diversify STAR's operations to include an online retail platform for their electronic goods. Non-controlling interests is measured at the proportionate share of the identifiable net assets as per IFRS 3 *Business Combinations.* On 1 July 2017 the equity portion of Online's summarised trial balance had the following information:

Account		Dr (R)	Cr (R)
Share Capital			1 000 000
Retained Earnings (opening)			12 550 500
Revenue			2 000 000
Cost of Sales		1 200 000	
Operating Expenses		400 000	
Income Tax Expense		250 000	
Revaluation Reserve	Note 1		500 000
Mark-to- Market Reserve	Note 1		50 000
			14 250 000

Note 1

All assets and liabilities were fairly valued except for Land and Buildings and the investments in listed shares. Land and buildings had a carrying amount of R9 345 000 on 1 July 2017 and a fair value of R10 500 000. The investment in listed shares had a carrying amount of R255 000 on 1 July, however, the carrying amount are yet to reflect the closing prices of these investments on 1 July 2017. After taking the closing prices into account, the fair value of the investment was R300 000. These shares are not traded for speculative reasons and Online elected to measure the investment in shares at fair value through other comprehensive income in terms of IFRS 9 *Financial Instruments.* The corporate tax rate is 28% and the CGT inclusion rate is 80%.

Note 2

Through discussion with the lawyers, it was found that Online also had an existing contingent liability on 1 July that was not recognised as it was not likely that they will be found liable. If they were to be found liable, the amount of the claim is estimated to be R200 000.

Note 3

Purchase acquisition agreement stated that STAR need to transfer the following to acquire the 80% share in Online:

- R9 000 000 cash, paid on 1 July 2017.
- An additional R5 000 000 in cash, if Online's EBITDA margin remained at 15% until 30 June 2018. The payment will be made 30 Days after 30 June 2018.

A valuation expert determined that the fair value of the additional payment is R2 300 000 based on a probability weighted calculation and the consideration of time value of money.

Note 4

Profit for the rest of the year was R156 000. The profit includes a vehicle sold to STAR for a profit of R20 000 on 30 September 2017. The vehicle has a remaining useful life of 4 years. The vehicle is no used by the sales representatives of STAR.

PART 2 **35 MARKS**

Lease Agreements

Diaz Group has a number of lease agreements to lease store rooms, machinery and office space. Ms Sisulu has provided you with two lease agreements and is very keen to understand the impact of the new IFRS 16 *Leases* (IFRS 16) standard.

Tracking System

On 1 January 2017, Diaz entered into a lease agreement with one of its subsidiaries, Speedy (Pty) Ltd (Speedy). The lease agreement was entered into to lease-out a newly purchased tracking system to Speedy. The tracking system will be used to track the different delivery vehicles across South Africa and to recover them if stolen. The tracking system was purchased by Diaz, specifically for the purpose of leasing it out to Speedy and have requested the supplier to program the system to the specific needs of Speedy in such a way that Speedy will be the only party that will be able to use the system. The terms of the lease agreement are as follows:

Original purchase price:	R399 000 (Incl. VAT)
Lease term:	5 years
Annual lease payments (payable in arrears on 31 December):	R115 600 (Incl. VAT)
Guaranteed residual:	R37 100 (Incl. VAT)
Unguaranteed residual value	R11 400 (Incl. VAT)
Incremental borrowing rate	10% pre-tax rate
Economic useful life of the tracking system	6 years
Title of ownership of the tracking system will not transfer over to Speedy at the end of the lease term.	

The CFO made the following comment in the email:

"The accountant did not recognise this lease agreement in either of the companies' books because in his opinion nothing really happened on group level and therefore did not see the need to recognise it. Will you please go through the agreement and ensure that the accounting treatment is in line with IFRS 16?"

Diaz financed the VAT (14%) as part of the lease agreement. The lease meets the definition of an Instalment Credit Agreement in terms of the VAT Act. A corporate tax rate of 28% is applicable. Depreciation on the tracking system is based on the straight line method over its useful life. The tracking system has a zero residual value for depreciation purposes. The system qualified for a section 12C allowance from SARS when it was newly purchased on 1 January 2017. As per section 12C, Diaz qualifies for a 40% allowance in the first year and 20% for subsequent years (40:20:20:20).

Lease of Distribution Truck

On 1 January 2017, Diaz entered into a seven-year lease of a distribution truck with an option to extend the lease for a further five years. As per the lease agreement, the lease payments are R171 000 per year during the initial term and R193 800 per year during the optional period, all payable at the beginning of each year. The cash price for the distribution truck is R798 000. The right of use asset is depreciated on a straight line basis over the lease period as per the accounting policy of Diaz.

Diaz incurred legal costs to the value of R22 800 on commencement of the lease. As an incentive to Diaz for entering into the lease, the lessor agreed to reimburse Diaz 50% of the legal costs made on 1 January 2017. On 1 January 2017, the date of the commencement of the lease, Diaz made the payment for the legal costs and received the lease incentives from the lessor. The reimbursement is not considered to be a VAT supply in terms of the VAT Act.

At the commencement of the lease, Diaz concluded that it is not reasonably certain to exercise the option to extend the lease, and therefore, determines that the lease term is seven years. Diaz's incremental borrowing rate is 8% per annum which reflects the equivalent risk on future borrowings by Diaz. Assume that all amounts include VAT. The lease qualifies as an Instalment Credit Agreement in terms of the VAT Act. Assume a VAT rate of 14% is applicable to Diaz.

PART 3 **20 MARKS**

Purchase of Land

Diaz Group acquired land with a fair value of R1 400 000 from King Ltd on 1 December 2017. The purchase agreement state that King Ltd has choice of settlement of:

1. Payment in cash based on the fair value of 100 000 Diaz Group ordinary shares at settlement date or
2. Settlement through issuing of 90 000 R1 shares.

The fair value per share of Diaz Group was R13.30 on 1 December 2017 when Diaz Group obtained control of the land. The fair value of the shares increased to R13.50 on 31 December 2017. SARS allows for a full deduction of the cash payment when it occurs in the future. Ignore VAT implications.

Employee share incentive scheme

Diaz Group has recorded impressive growth in their earnings over the past few years and the board of directors decided to reward employees through an employee incentive scheme. This would align the interests of the employees with the company's and shareholders' interests. The incentive scheme was also implemented to assist in retaining skilled staff in key positions within the company's operations.

In light of this, Diaz Group issued 500 share options to each of the 200 key employees on 1 January 2016 to acquire ordinary shares when vesting conditions are satisfied. The strike price of these options is R13 per share which is equal to the fair value of a Diaz Group ordinary share on 1 January 2016. The employees will receive benefit of future growth of the share price. The share options vest on 31 December 2021 provided both of the following vesting conditions are satisfied:

Condition A: The employee did not leave employment of Diaz throughout the vesting period.

Condition B: The market price of Diaz Group ordinary shares maintain a 10% growth until 31 December 2021.

The following estimates are applicable to the share incentive scheme:

Date of estimation	**Expected Cumulative number of employees leaving during the vesting period**
31 December 2016	25
31 December 2017	30

The fair values of the options were determined as follows:

	Before adjusting for any of the vesting conditions	**After adjusting for the market conditions only**
	Rand	**Rand**
1 January 2016	18.20	15.00
31 December 2016	17.25	14.20
31 December 2017	17.33	14.33

PART 4 **30 MARKS**

STAR recently struggled to sell their Super Ultra High Definition (SUHD) Smart TV's (SUHD) inventory due to the extremely high prices and the current economic downturn experienced in South Africa. To increase sales before year end, STAR decided to run a promotion on its SUHD TV's. Customers who purchased five or more TVs during December 2017 would have qualified for a 10% discount on the SUHD TV selling price and received a free two-year general maintenance plan. The pricing on each of the components and terms at the time is listed in the table below together with the average market price of SUHD TV's:

Terms	Additional Information to contract	STAR Selling Price (Incl. VAT)	Average Market Price (Incl. VAT)
SUHD TV		R114 000	R119 700
Free one-year warranty which covers the full replacement of any TV due to manufacturing defects.	The one-year manufacturer warranty is not sold separately. The estimated cost of this warranty (based on the expected manufacturing defects) is R10 000 per SUHD TV. Only 2% of all TV's have required replacement within a period of one year due to manufacturing defects.	n/a	n/a
Two-year general maintenance plan which covers a general maintenance and replacement of parts if needed.	The additional two-year service plan is normally negotiated separately with customers. Generally 55% of customers purchase this service plan with the TV. The average costs of servicing and maintaining the TVs and replacing TV parts under this service plan is R15 000 per TV sold.	R11 400	R13 680

TradeX (Pty) Ltd (TradeX), an existing customer of STAR, decided to take advantage of the special discounted offer on SUHD TVs and bought and took delivery of ten SUHD TVs for a total price of R1 026 000 (Incl. VAT) (discount included) on 22 December 2017. TradeX paid 50% of the contract price on that day. The remaining 50% of the contract price was payable within 30 days from that date. The negotiated terms were in accordance with the customary business practice established with TradeX over time and was verbally agreed upon by the parties.

The CFO of STAR, Ms Zulu, asked your assistance with regards to the accounting treatment of the contract with TradeX in terms of IFRS 15 *Revenue from Contracts with Customers.*

PART 5 **28 MARKS**

Ms Sisulu has requested you to review the following arrangements in Excel (Pty) Ltd as in both cases she is unsure as to how to account for them due to the complex terms of these agreements.

Investment in Bonds

On 1 January 2016 Excel (Pty) Ltd (Excel) purchased bonds in Air South Africa (SOC) Ltd ('ASA') at a discount of 10%. The total face value of the investment in bonds is R1 000 000. A coupon rate of 10% per annum is payable in arrears on 31 December. The bonds will be redeemed on 31 December 2020 at a premium of 20%. Transaction costs paid by Excel amounted to R20 000. The investment in bonds is held within a business model whose objective is to collect contractual cash flows as Excel don't usually trade with these instruments.

On 1 January 2016 Vuvuzela assessed the probability that ASA might default on payments and estimated the 12-month expected credit losses on the bonds to be R10 000. On 31 December 2016 there was a significant deterioration in the credit quality of ASA.

On 31 December 2017, the bonds on ASA was considered to be credit impaired due to the poor economic growth and the credit downgrades bay the ratings agencies. Excel modified the agreement with ASA, by increasing the repayment date to 31 December 2022 and reducing the redeemable amount to 90% of the face value of the bonds. The following information was available regarding credit losses:

Credit Losses	**1 Jan 2016**	**31 Dec 2016**	**31 Dec 2017**
12-Month Expected Credit Losses	R10 000	R14 000	R20 000
Life time Expected Credit Losses	R20 000	R25 000	R45 000

The expected credit losses allowances are regarded as a 'provision for doubtful debts' as per the old IAS 39 model. SARS therefore allows for a 25% deduction for the allowance in the year of origination and the remaining 75% when the debt is written off.

Expansion of business through preference shares.

Excel issued 5 million R10 par value 10% cumulative preference shares on 1 January 2017. The preference shares are convertible at the option of the holder into ordinary shares (1 share for every 5 held) on 31 December 2020. If the preference shares are not converted, they will be redeemed at a premium of 20% on the par value. The appropriate pre-tax market related rate for similar instruments is 15%. The post-tax rate is 10.80%.

PART 6 **7 MARKS**

To: accountant@diaz.co.za
From: psisulu@diaz.co.za
Date: 20 April 2018
Subject: IFRS for SMEs

Dear accountant

We have been using full IFRS for years now, but I recently hear from our auditors that IFRS for SMEs is actually more beneficial for privately owned companies in South Africa. I had a look at what the IASB has been saying about IFRS for SMEs and have included an extract from their website below:

The IFRS for SMEs Standard is a small Standard that is tailored for small companies. It focuses on the information needs of lenders, creditors and other users of SME financial statements who are interested primarily in information about cash flows, liquidity and solvency. And it takes into account the costs to SMEs and the capabilities of SMEs to prepare financial information.

While based on the principles in full IFRS Standards, the IFRS for SMEs Standard is stand-alone. It is organised by topic. The IFRS for SMEs Standard reflects five types of simplifications from full IFRS Standards:

- *some topics in full IFRS Standards are omitted because they are not relevant to typical SMEs;*
- *some accounting policy options in full IFRS Standards are not allowed because a more simplified method is available to SMEs;*
- *many of the recognition and measurement principles that are in full IFRS Standards have been simplified;*
- *substantially fewer disclosures are required; and*
- *the text of full IFRS Standards has been redrafted in 'plain English' for easier understandability and translation.*

Will you please explain to me what the major differences (simplifications) are for non-monetary assets?

Kind regards,

Ms Sisulu

UNIVERSITY OF JOHANNESBURG

SUPPLEMENTRY FINAL ASSESSMENT OPPORTUNITY

ADVANCED ACCOUNTING

REQUIRED

PART 1		
a)	Provide all the relevant pro-forma journal entries to consolidate Online (Pty) Ltd in the consolidated financial statements of Diaz Group for the reporting period ended 31 December 2017. Journal narrations are not required.	**(20)**
PART 2		
b)	Discuss whether the lease agreement with Speedy (Pty) Ltd is a finance lease in terms of IFRS 16 *Leases* in the accounting records of Diaz (Pty) Ltd. **Please note:** There is no need to use the state, define, apply and conclude method for discussion purposes.	**(5)**
c)	Provide the relevant journal entries to account for the lease of the tracking system in the financial statements of Diaz (Pty) Ltd for the reporting period ended 31 December 2017. Journal narrations are not required. • The journals should be presented using the net investment in the lease method. • Show all calculations clearly. • Include VAT and deferred tax implications as part of your answer. • Assume a corporate tax rate of 28% and a VAT tax rate of 14%	**(15)**
d)	Provide the relevant journal entries to account for the lease of the distribution truck in the financial statements of Diaz (Pty) Ltd for the reporting period ended 31 December 2017. Journal narrations are not required. • Show all calculations clearly. • Include VAT and deferred tax implications as part of your answer. • Assume a corporate tax rate of 28% and a VAT tax rate of 14%	**(20)**

PART 3		
e)	Provide the relevant journal entries, including deferred tax, to account for the purchase of the land in the separate financial statements of Diaz (Pty) Ltd for the reporting period ended 31 December 2017. Journal narrations are not required.	**(10)**
f)	Provide the relevant journal entries to account for transactions relating to the share incentive scheme in the separate financial statements of Diaz (Pty) Ltd for the reporting period ended 31 December 2017. Journal narrations are not required.	**(10)**
PART 4		
g)	Write a memorandum to the Financial Director of STAR (Pty) Ltd in which you advise her how she should recognise and measure the revenue transaction with TradeX for the year ended 31 December 2017 in terms of IFRS 15 *Revenue from Contracts with Customers.* The marks are allocated to the following steps as per IFRS 15: • Step 1 – (5) • Step 2 – (7) • Step 3 – (4) • Step 4 – (5) • Step 5 – (7) • Format & Presentation (2) Please use a VAT tax rate of 14% for all calculations.	**(30)**
PART 5		
h)	Provide the journal entries to account for the investment in Transkorp Bonds in the financial statements of Excel (Pty) Ltd for the financial reporting periods ended 31 December 2016 **and** 31 December 2017**.** Ignore deferred tax consequences. Journal narrations are not required.	**(18)**
i)	Discuss the deferred tax treatment of the allowance for the expected credit losses on 31 December 2017 in the accounting records of Excel (Pty) Ltd in terms of IAS 12 *Income Taxes*.	**(5)**
j)	Discuss the classification and initial measurement of the preference shares issued by Excel (Pty) Ltd in terms of IAS 32 *Financial Instruments: Presentation* in the financial statements for the reporting period ended 31 December 2017.	**(10)**
PART 6		
k)	Briefly discuss the key differences between full IFRS and IFRS for SMEs for non-monetary assets only. **Please note:** There is no need to use the state, define, apply and conclude method for discussion purposes.	**(7)**

PLEASE NOTE:

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