

LEARNING UNIT NUMBER	1
TITLE OF LEARNING UNIT	The Conceptual Framework for Financial Reporting; Presentation and Disclosure in Financial Statements; Income Taxes; Basis of Preparation of Financial Statements; Financial Instruments; The Effects of Changes in Foreign Exchange Rates; Share-based payments
NOTIONAL STUDY HOURS	30
NUMBER OF PLANNED SELF-REFLECTIVE ACTIVITIES	5 Examples; 9 Questions; 1 Case study
NUMBER OF ASSESSMENT LINKED ACTIVITIES	1 (Test 1/2026 – 14 & 15 April 2026)

1.1 Introduction

Within learning unit 1 we will discuss the following individual topics:

Topic	IFRS Standard	Description
1.1		The Conceptual Framework for financial reporting
1.2	IFRS 18	Presentation and Disclosure in Financial Statements
1.3	IAS 12, FRP 1, IFRIC 23	Income Taxes
1.4	IAS 8	Basis of Preparation of Financial Statements
1.5	IAS 32, IFRS 7, IFRS 9, IFRIC 19	Financial Instruments
1.6	IAS 21	The Effects of Changes in Foreign Exchange Rates
1.7	IFRS 2	Share-based payments

The above will be discussed as individual topics within this learning unit.

1.2 Purpose of learning unit

Students should be able to:

- Apply financial reporting in integrated case studies as set out in the Conceptual Framework for IFRS.
- Assess the recognition and derecognition criteria of an element as specified in the relevant IFRS in an integrated case study.
- Evaluate the measurement basis that is applicable to an element as guided by the relevant IFRS in an integrated case study.
- Prepare and discuss general purpose financial statements, including consolidated financial statements, in accordance with IFRS.

1.3 Assessment criteria

- Interrogate integrated case studies to evaluate the Conceptual Framework for financial reporting.
- Recognise an item that is an asset, a liability, equity, income, or expense for inclusion in the financial statements.
- Derecognise from the financial statements an item that is no longer an asset, a liability, equity, income or expense.
- Interpret the recognition and/or derecognition of an asset, a liability, equity, income, or expense in a given scenario against the applicable IFRS.

- Assess the measurement basis for an asset or a liability in a given scenario against the requirements of the applicable IFRS.
- Propose improvements to the measurement basis for an asset or a liability based on the requirements of the applicable IFRS.
- Compile the general financial statements, including consolidated financial statements, in accordance with IFRS.
- Assess the appropriateness of disclosures of financial information in relation to general purpose and consolidated financial statements, prepared in accordance with IFRS.

1.4 How to approach each learning unit

- Please read the prescribed study material for each topic in the learning unit thoroughly before studying the additional information.
- Study the overview of the individual topic – we have included an overview for each individual topic.
- Answer the examples/questions in the individual topic, if applicable, and make sure you understand the principles contained in the questions.
- Consider whether you have achieved the exit level outcomes (refer to learning unit 0).
- After you have completed all the individual topics in the learning units, answer the integrated questions to test whether you have mastered the contents of this learning unit.
- You will be assessed in test 1 on the contents of this learning unit.



Discussion forum

A general discussion forum has been set up for each topic within this learning unit. It is strongly recommended that you post your questions and comments on the forum as you work through the learning unit. Your lecturers are more than happy to assist you on your learning journey.

TOPIC 1.1

THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING



INTRODUCTION

The Conceptual Framework for Financial Reporting (Conceptual Framework) describes the objective of, and the concepts for, general purpose financial reporting. The Conceptual Framework is not a standard. Nothing in the Conceptual Framework overrides any Standard or any requirement in a Standard.



PRESCRIBED STUDY MATERIAL

The Conceptual Framework for Financial Reporting

SAICA Student Handbook 2025/2026; Volume1; Part A1

The Conceptual Framework for Financial Reporting was covered as part of your undergraduate studies. It is important that you revise the study material and concepts if you are not familiar with the content.

Also, note that Unisa follows the limited open-book policy as prescribed by SAICA and that you will be allowed to use the SAICA Student Handbook during assessments.

The Conceptual Framework for Financial Reporting is assessed on Proficiency **Level 3**

Let's look at the overview of the Conceptual Framework for Financial Reporting.

Overview of the Conceptual Framework

Chapter 1 Objective of general purpose financial reporting

Introduction.

Objective, usefulness and limitations of general purpose financial reporting.

Information about the reporting entity's economic resources, claims against the entity and changes in resources and claims.

- Economic resources and claims.
 - Changes in economic resources and claims.
 - Financial performance reflected by accrual accounting.
 - Financial performance reflected by past cash flows.
 - Changes in economic resources and claims not resulting from financial performance.
- Information about use if the entity's economic resources.

Chapter 2 Qualitative characteristics of useful financial information

Introduction.

The qualitative characteristics of useful information.

The **fundamental** qualitative characteristics are:

- Relevance
- Faithful representation
- Applying the fundamental qualitative characteristics

The **enhancing** qualitative characteristics are:

- Comparability
- Verifiability
- Timeliness
- Understandability
- Applying the enhancing characteristics

The cost constraint on useful financial reporting.

Chapter 3 Financial statements and the reporting entity

Financial statements:

- Objective and scope of financial statements.
- Reporting period.
- Perspective adopted in financial statements.
- Going concern assumption.

The reporting entity.

- Consolidated and unconsolidated financial statements.

Chapter 5 Recognition and Derecognition

The recognition process.

Recognition criteria - An asset or liability is recognised only if recognition will provide users of financial statements with information that is useful, i.e. with:

- Relevant information;
 - Faithful representation of the asset or liability
- Derecognition.

Chapter 4: Elements of the financial statements

Introduction.

Definition of an asset

An asset is a present resource controlled by the entity as a result of past events.

An economic resource is a right that has the potential to produce economic benefits.

This section discusses three aspects of the definition:

- Right.
- Potential to produce economic benefits.
- Control.

Chapter 6

Introduction.

Measurement bases:

- Historical cost.
- Fair value.
- Value in use and fulfilment value.
- Current cost.

Information provided by particular measurement bases

- Historical cost.
- Fair value.
- Value in use and fulfilment value.
- Current cost.

Factors to consider when selecting a measurement basis.

Measurement of equity.

Cash flow-based measurement techniques.

Definition of a liability

- A present obligation of the entity to transfer an economic resource as result of past events.
- For a liability to exist, three criteria must be satisfied:
- Obligation.
 - Transfer of an economic resource.
 - Present obligation as a result of past events

Chapter 7: Presentation and Disclosure

Presentation and disclosure as communication tools.
Presentation and disclosure objectives and principles.
Classification.
Aggregation.

Assets and Liabilities

- Unit of account.
- Executory contract.
- Substance of contractual rights and contractual obligations.

Chapter 8: Capital

Concepts of capital.
Concepts of capital maintenance.
Capital maintenance adjustments.

Definition of equity

- The residual interest in the asset of the entity after deducting all its liabilities

Definition of income and expenses

- Income is increases in assets or decreases in liabilities that result in increases in equity other than those relating to contributions from holders of equity claims.
- Expenses are decreases in assets or increases in liabilities that result in decreases in equity other than those relating to distributions to holders of equity claims.

**DISCUSSION FORUM**

A general discussion forum has been set up for each topic within this learning unit. It is strongly recommended that you post your questions and comments on the forum as you work through the learning unit. Your lecturers are more than happy to assist you on your learning journey.

The discussion forum for topic 1.1 can be accessed here:

<https://mymodules.dtls.unisa.ac.za/mod/forum/view.php?id=1340263>

TOPIC 1.2 – PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS



INTRODUCTION

The objective of this Standard is to provide guidelines for the presentation and disclosure of information in the general-purpose financial statements, to help ensure they provide relevant information that faithfully represents an entity's assets, liabilities, equity, income and expenses.



PRESCRIBED STUDY MATERIAL

IFRS 18 Presentation and Disclosure in Financial Statements

SAICA Student Handbook 2025/2026;

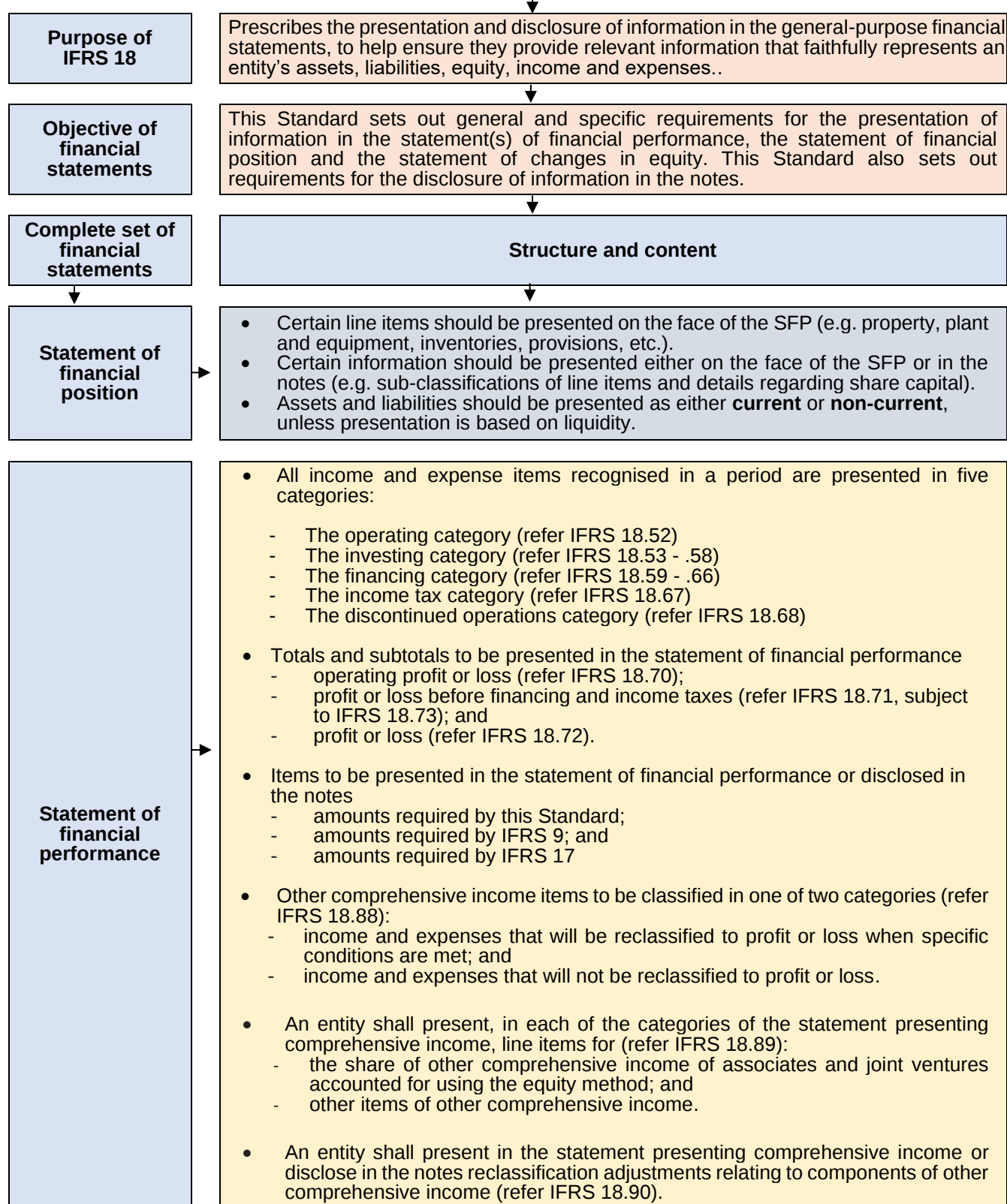
Note that Unisa follows the limited open-book policy as prescribed by SAICA and that you will be allowed to use the SAICA Student Handbook during assessments.

Description	Level	Notes
IFRS 18 is assessed at proficiency level 3 , except for the following:		
Scope	Level 1	
Additional disclosures when compliance with the specific requirements in IFRS is insufficient	Excluded	Not core / Not prevalent
Presentation of entities with specified main business activities	Excluded	Not core
Judgement to determine whether to present additional line items	Excluded	Not core
Management-defined performance measures (MPMs) • Identification of MPMs • Disclosure of MPMs	Level 1 Excluded	Not core
Change in use of an asset	Level 1	To maintain alignment with the overall proficiency level of the topic in the PoE document
Classification of foreign exchange differences on transaction that does not involve only the raising of finance (specifically par. B67)	Excluded	Not core
Presentation and disclosure of expenses classified in the operating category using characteristics of nature and function (i.e., a mixture of function and nature)	Excluded	Not core / Not prevalent

Let's look at the overview of IFRS 18 Presentation and Disclosure in Financial Statements.

Overview of IFRS 18 Presentation and Disclosure in Financial Statements

PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS



Statement of changes in equity	• An entity shall present a statement of changes in equity as required by IFRS 18.10. The statement of changes in equity shall include (refer IFRS 18.107): - total comprehensive income for the reporting period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests; - for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with IAS 8; and - for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) presenting resulting changes.
Statement of cash flows	• Refer to learning unit 6.
Notes	• Structure (refer IFRS 18.113) - information about the basis of preparation of the financial statements and the specific accounting policies used. - information required by IFRS Accounting Standards that is not presented in the primary financial statements; and - other information that is not presented in the primary financial statements, but is necessary for an understanding of any of them. • Management-defined performance measures (refer IFRS 18.117) - A management-defined performance measure is a subtotal of certain income and expenses line-items • Capital (refer IFRS 18.126) - An entity shall disclose in the notes information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital. • Other disclosures (refer IFRS 18.130) - An entity shall present certain disclosures in either the statement of financial position or the statement of changes in equity or disclose in the notes
Aggregation and disaggregation	• Principles of aggregation and disaggregation (refer IFRS 18.41) - For the purposes of this Standard, an item is an asset, liability, equity instrument or reserve, income, expense or cash flow or any aggregation or disaggregation of such assets, liabilities, equity, income, expenses or cash flows. A line item is an item that is presented separately in the primary financial statements. Other material information about items is disclosed in the notes. Unless doing so would override specific aggregation or disaggregation requirements in IFRS Accounting Standards. - An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an IFRS Accounting Standard.

EXAMPLE 1 (38 marks)

Rock Ltd Group is a manufacturer, where neither investing in relevant assets or providing finance to customers is a main business activity.

The following information relates to the Rock Ltd Group for the year ended 31 December 20.11:

1. Consolidated revenue amounted to R2 311 200 for the year. The costs to deliver these goods to clients amounted to R22 100. There is no credit risk associated with the customers of Rock Ltd Group.
2. Inventories consisted of the following as at 31 December 20.11 and 31 December 20.10:

	31 Dec 20.11 R	31 Dec 20.10 R
Raw materials	23 000	21 500
Consumables	5 000	4 200
Work-in-progress	35 600	28 900
Finished goods	<u>31 200</u>	<u>25 600</u>
	<u>94 800</u>	<u>80 200</u>

3. Raw materials amounting to R920 200 and consumables amounting to R18 900 were purchased during the year.
4. The following salaries were paid during the 20.11 year:

	R
Factory works	67 800
Sales agents	84 200
Administrative personnel	93 800

5. Stationery amounting to R11 000 were used by the administrative personnel during the 20.11 year, while advertising costs amounted to R14 800.
6. Depreciation provided for the 20.11 year is as follows:

	R
Plant	54 300
Delivery vehicles	26 700
Office buildings	8 200

In terms of the Income Tax Act, the South African Revenue Services (SARS) does **not** grant an income tax capital allowance on the office buildings. Depreciation on plant and delivery vehicles did not give rise to any temporary difference for capital gains tax purposes.

7. During the 20.11 financial year, dividends amounting to R7 000 were received on unlisted investments, while share of profit from associates amounted to R150 000.
8. Interest paid on the bank overdraft amounted to R33 300 for 20.11.
9. Rock Ltd was paid for the use of their trademark for six months during the 20.11 year at R500 per month.
10. Donations (not deductible for tax purposes) amounting to R6 000 were made to various charity organisations during the 20.11 year.
11. The non-controlling shareholders' interests in the subsidiaries' profit for the 20.11 year amounted to R45 100.
12. The normal income tax rate is 27%. You may assume that there are no other temporary differences except those that are evident from the question.

REQUIRED	Marks
(a) Prepare the consolidated statement of financial performance of the Rock Ltd Group for the year ended 31 December 20.11. Expenses should be classified according to their <i>function</i> as per IFRS 18 paragraph 81. All notes to the statement of financial performance, excluding accounting policy notes, should be supplied.	22½
(b) Prepare the consolidated statement of financial performance of the Rock Ltd Group for the year ended 31 December 20.11. Expenses should be classified by their <i>nature</i> as per IFRS 18 paragraph 80. Only the note relating to profit before income taxes should be supplied.	15½
Please note: • Comparative figures are not required. • Ignore any Value-Added Taxation (VAT) implications. • Your answer must comply with IFRS Accounting Standards.	

EXAMPLE 1 - Suggested solution**(a) Classification of expenses by function****ROCK LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED 31 DECEMBER 20.11**

	Note	R	
Revenue		2 311 200	(½)
Cost of sales ¹ [C1]		(1 046 600)	(3)
Other operating income ² (500 x 6)		3 000	(1)
Distribution costs [C2]		(147 800)	(2)
Administrative expenses [C3]		(113 000)	(1½)
Other operating expenses		(6 000)	(½)
Operating profit		1 000 800	
Share of profit of associates		150 000	(½)
Income from investments ³		7 000	(½)
Profit before financing and income taxes	2	1 157 800	
Finance costs		(33 300)	(½)
Profit before income tax expense		1 124 500	
Income tax expense [C4]	3	(274 876)	(½)
PROFIT⁴ (IFRS 18.86(a))		849 624	
Other comprehensive income ⁴ (IFRS 18.86(b))		-	
TOTAL COMPREHENSIVE INCOME⁴ (IFRS 18.86(c))		849 624	
Profit attributable to (IFRS 18.76):		804 524	
- Owners of the parent (balancing figure)		45 100	(½)
- Non-controlling interests (given)		849 624	(½)
Total comprehensive income attributable to (IFRS 18.87):		804 524	
- Owners of the parent (balancing figure)		45 100	(½)
- Non-controlling interests (given)		849 624	(½)

**DISCUSSION**

1. In accordance with IFRS 18.82(a), when expenses are classified by function in the operating category of the statement of profit or loss, a separate line item for cost of sales must be presented, which must include the following: those costs previously included in the measurement of inventory that have now been sold, unallocated production overheads and abnormal amounts of production costs of inventories, i.e. Cost of Sales (IAS 2.38).
2. Also note the distinction between "other operating income" and "income from investments".
3. Furthermore, note that should a question state that dividends have been received by the company, it may be assumed that the dividends were received net of Dividends Tax. This is due to the fact that Dividends Tax is a withholding tax which will be paid on the shareholder's behalf by the company paying the dividends, therefore resulting in the shareholder receiving the dividend amount net of Dividends Tax.
4. This question did not have other comprehensive, hence total comprehensive income is equal to the profit

ROCK LTD GROUP

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.11

Operating profit

The nature of specified expenses related to the line item in the operating category of profit or loss is as follows:

	R	
<i>Depreciation per line item</i> (IFRS 18.83(a)(i) and (b)(i))		
Cost of sales	54 300	(1/2)
Distribution costs	26 700	(1/2)
Administrative expenses	8 200	(1/2)
	89 200	

Depreciation represents amounts recognised in accordance with IAS 16 *Property, Plant and Equipment* (IFRS 18.82(b)). The total includes amounts that were capitalised to inventories (IFRS 18.83(b)(ii)).

<i>Employee benefits line item</i> (IFRS 18.83(a)(iii) and (b)(i))		
Cost of sales	67 800	(1/2)
Distribution costs	84 200	(1/2)
Administrative expenses	93 800	(1/2)
	245 800	

Employee benefits represent the amount recognised for the year in accordance with IAS 19 *Employee Benefits* (IFRS 18.82(b)). The total includes amounts that were capitalised to inventories. (IFRS 18.83(b)(ii)).

Donations included in "other operating expenses" (IFRS 18.113(c))	6 000	(1/2)
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1. Income tax expense

Major components of tax expense	R	
SA normal tax Current		
- Current year [C4]	<u>274 876</u>	(3)

Tax rate reconciliation

Accounting profit	1 124 500	(1/2)
Tax at 27	303 615	
Tax effect of non-deductible/non-taxable items:		
- Depreciation on office buildings (8 200 x 27%)	2 214	(1/2)
- Donations (6 000 x 27%)	1 620	(1/2)
- Dividends received (7 000 x 27%)	(1 890)	(1/2)
- Share of profit of associates (150 000 x 27%)	(40 500)	(1/2)
Income tax expense	<u>265 059</u>	<u>(22 1/2)</u>

(b) Classification of expenses by nature ROCK LTD GROUP
CONSOLIDATED STATEMENT OF FINANCIAL PERFORMANCE INCOME FOR THE YEAR
ENDED 31 DECEMBER 20.11

	Note	R	
Revenue		2 311 200	(¹ / ₂)
Other operating income (500 x 6)		3 000	(1)
Changes in inventories of finished goods and work in progress [C5]		12 300	(1 ¹ / ₂)
Raw materials and consumables used [C6]		(936 800)	(3)
Employee benefit expense (67 800 + 84 200 + 93 800)		(245 800)	(1 ¹ / ₂)
Depreciation expense (54 300 + 26 700 + 8 200)		(89 200)	(1 ¹ / ₂)
Other operating expenses [C7]		(53 900)	(2)
Operating profit		1 000 800	
Share of profit of associates		150 000	(¹ / ₂)
Income from investments		7 000	(¹ / ₂)
Profit before financing and income taxes	2	1 157 800	
Finance costs		(33 300)	(¹ / ₂)
Profit before income tax expense		1 124 500	
Income tax expense [C4]	3	(274 876)	(¹ / ₂)
PROFIT		849 624	
Profit attributable to:			
- Owners of the parent (balancing figure)		804 524	(¹ / ₂)
- Non-controlling interests (given)		45 100	(¹ / ₂)
		<u>849 624</u>	
Profit attributable to:			
- Owners of the parent (balancing figure)		804 524	(¹ / ₂)
- Non-controlling interests (given)		45 100	(¹ / ₂)
		<u>849 624</u>	

ROCK LTD GROUP

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.11

2. Operating profit

The nature of specified expenses related to the line items in the operating category of profit or loss is as follows:

Donations included in "other operating expenses" (IFRS 18.113(c))	6 000	(¹ / ₂)
		<u>(15¹/₂)</u>

CALCULATIONS

C1. Cost of sales

Opening inventories	80 200	[½]
Production costs		
Salaries: factory workers	67 800	[½]
Raw materials purchased	920 200	[½]
Consumables purchased	18 900	[½]
Depreciation: plant	54 300	[½]
Closing inventories	<u>(94 800)</u>	[½]
	<u>1 046 600</u>	
		<u>[3]</u>

C2. Distribution costs

Salaries: sales agents	84 200	[½]
Depreciation: delivery vehicles	26 700	[½]
Delivery costs	22 100	[½]
Advertising costs	<u>14 800</u>	[½]
	<u>147 800</u>	
		<u>[2]</u>

C3. Administrative expenses

Salaries: administrative personnel	93 800	[½]
Depreciation: office buildings	8 200	[½]
Stationery	<u>11 000</u>	[½]
	<u>113 000</u>	
		<u>[1½]</u>

C4. Taxation

Profit before income taxes	1 124 500	[½]
Non-taxable/non-deductible differences:		
- Depreciation on office building	8 200	[½]
- Donations	6 000	[½]
- Dividends received	(7 000)	[½]
- Share of profit of associates	<u>(150 000)</u>	[½]
Taxable profit	<u>981 700</u>	
Current tax at 27%	<u>265 059</u>	[½]
		<u>[3]</u>

C5. Change in inventory levels

Opening inventories (28 900 + 25 600)	(54 500)	[½]
Closing inventories (35 600 + 31 200)	<u>66 800</u>	[½]
Increase in inventories results in an increase in profit	<u>12 300</u>	<u>[½]</u>

C6. Raw materials and consumables

Opening inventories (21 500 + 4 200)	25 700	[1]
Purchased (920 200 + 18 900)	939 100	[1]
Closing inventories (23 000 + 5 000)	<u>(28 000)</u>	[1]
Consumed during the year	<u>936 800</u>	<u>—</u>
		<u>[3]</u>

C7. Other operating expenses

Stationery utilised	11 000	[1½]
Delivery costs	22 100	[1½]
Advertising costs	14 800	[1½]
Donations	<u>6 000</u>	[1½]
	<u>53 900</u>	<u>[2]</u>

EXAMPLE 2 (20 marks)**Vintage Ltd**

Vintage Ltd specialises in the purchase of wine from wine regions around the world. The company acquires superior wine from boutique farms, some of which they will store to age before it is sold to customers.

For the financial year ended 30 June 20.13, the company's inventory consisted of the following:

(a) Aged wines

Description	Years to mature	Ageing completed	Cost R	Market value R
Cabernet Sauvignon	4 – 20 years	30%	800 000	1 600 000
Pinot Noir	2 – 8 years	60%	750 000	1 750 000
Merlot	2 – 10 years	0%	350 000	680 000
Chardonnay	2 – 6 years	50%	454 000	660 000
			<u>2 354 000</u>	<u>4 690 000</u>

(b) Wines available for sale at date of purchase

Vintage Ltd has a variety of wines with little to no aging potential. These wines are immediately available for sale and usually sell within a year from the time they have been purchased.

Description	Cost R	Market value R
Variety of white wines	500 000	630 000
Rosé and blush wines	450 000	575 000
	<u>950 000</u>	<u>1 205 000</u>

(c) Wines available for sale at date of purchase

Mr Vin Tage, owner of Vintage Ltd, has a valued appreciation for exceptional wines and travels the world in order to obtain prized wines for Vintage Ltd's collection of investment wines. These wines are considered by some to be Veblen goods; Veblen goods are goods for which the demand increases, rather than decreases, when the price thereof rises.

Description	Cost R	Market value R
Bordeaux	900 000	1 800 000
Burgundy	250 000	700 000
Vintage port	1 000 000	2 100 000
	<u>2 150 000</u>	<u>4 600 000</u>

Mr Tage is known for his prestigious collection of investment wines which has been collected over many years. It is only a few rare customers who have been able to purchase any of these wines from Vintage Ltd.

REQUIRED	Marks
(a) Disclose the above items in the statement of financial position of Vintage Ltd for the year ended 30 June 20.13.	6
Communication skills: presentation and layout	2
(b) For each line-item disclosed in terms of (a) above, discuss the following: i. The reason the item was classified as current or non-current. ii. The disclosure of the line item itself.	4 6
Communication skills: logical flow and conclusion	2
Please note: - Comparative figures are not required. - Notes to the financial statements are not required. - Ignore any Value-Added Taxation (VAT) implications. - Ignore any normal income tax implications. - Your answer must comply with IFRS Accounting Standards.	

EXAMPLE 2 - Suggested solution

(a) VINTAGE LTD

STATEMENT OF FINANCIAL POSITION FOR THE YEAR ENDED 30 JUNE 20.13

	Notes	20.13 R'000	
ASSETS			
Non-current assets			
Investment wines	2	4 600	(1)
Current assets			
Inventory [C1]	3		
- Twelve-month operating cycle		1 867	(3)
- Operating cycle more than twelve months		1 437	(2)
Total assets		<u>7 904</u>	
		Total	<u>(6)</u>
		Communication skills: presentation and layout	<u>(2)</u>

(b) Discussion

(i) Current versus Non-current:

Non-current

Investment wines are classified as non-current since these wines are purchased for their investment value and not to be sold within the normal operating cycle of the company. (1)

Current

Vintage Ltd has more than one operating cycle:

- An operating cycle of twelve months for wines which are ready to be sold as soon as they have been purchased, and (1)
- an operating cycle which exceeds twelve months, for the wines which need to mature before they are sold

According to IFRS 18.99, an entity classifies an asset as current when it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle. (1)

The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When an entity's normal operating cycle is not clearly identifiable, it is assumed to be 12 months (IFRS 19.B95).

Although Vintage Ltd has more than one operating cycle, the company will disclose inventory sold within their normal operating cycles as current items. (1)

(4)

(ii) Disclosure of items:

Investment wines

IFRS 18.106 indicates that the descriptions used in the statement of financial position may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position. (1)

Although the company specialises in wines, wine as an investment may not be a familiar investment to the majority of users of the financial statements and hence the description of this line item is amended to provide information relevant to the operations of the entity. (1)

Inventory

If inventory of different operating cycles were held, and it was material to readers' understanding of an entity's financial position, then the general requirement of IFRS 18.24 and 106 require disclosure of further information. (1)

IFRS 18.24 indicates that additional line items and subtotals are included in the statement of financial position if such presentations are necessary for the statement of financial position to provide a useful structured summary of the entity's financial position. (1)

For additional line items for assets and liabilities, an entity bases its judgements on an assessment of the nature or function of the assets or liabilities (IFRS 18.B109). (1)

The duration holding and the timing of recovery of the aged wines is more than twelve months (IFRS 18.B110(c)). It is not customary for wine traders to sell wine only after it has aged. (1)

Thus, the nature of this inventory is worth disclosing to the users of the financial statements. The aged wines also form a material part of the inventory balance, which is why its size also determines separate disclosure in the statement of financial position. (1)

In addition, IFRS 18.B93 indicates that the expected dates of realisation of assets and liabilities is useful information in assessing the liquidity and solvency of an entity. Thus, an entity will disclose the amount of inventory that is expected to be recovered more than twelve months after the reporting period. (1)

CALCULATIONS

C1. Inventory

Twelve-month operating cycle

Description	Aging completed	Cost	Total	
		R		
Cabernet Sauvignon	30%	800 000	240 000	[½]
Pinot Noir	60%	750 000	450 000	[½]
Merlot	0%	350 000	-	[½]
Chardonnay	50%	454 000	227 000	[½]
		<u>2 354 000</u>	<u>917 000</u>	
Variety of white wines			500 000	[½]
Rose and blush wines			<u>450 000</u>	[½]
			<u>1 867 000</u>	

Operating cycle more than twelve months

Description	Aging completed	Cost	Total	
		R		
Cabernet Sauvignon	100% - 30%	800 000	560 000	[½]
Pinot Noir	100% - 60%	750 000	300 000	[½]
Merlot	100% - 0%	350 000	350 000	[½]
Chardonnay	100% - 50%	454 000	227 000	[½]
		<u>2 354 000</u>	<u>1 437 000</u>	

TOPIC 1.3 – INCOME TAXES



INTRODUCTION

Taxation represents an unavoidable expense for most entities. Apart from various income taxes that include all domestic and foreign taxes, it is also necessary to account for deferred taxation. Deferred tax represents tax that will be paid/saved in future periods when the carrying amounts of the assets/liabilities are recovered/settled.



PRESCRIBED STUDY MATERIAL

1. **IAS 12 Income Taxes**
2. **FRP 1 Substantively enacted tax rates and tax laws**
3. **The following document is excluded:**
SIC 25 Income taxes – Changes in the tax status of an entity or its shareholders

SAICA Student Handbook 2025/2026; Volume1; Part A2

IAS 12 and FRP 1 were covered as part of your undergraduate studies. It is important that you revise the study material and concepts if you are not familiar with the content.

Also note that Unisa follows the limited open-book policy as prescribed by SAICA and that you will be allowed to use the SAICA Student Handbook during assessments.

Description	Paragraph	Level	Notes
IAS 12 and FRP 1 are assessed at proficiency level 3 , except for the following			
	38 to 45	Excluded	Group temporary differences

Let's look at the overview of IAS 12 Income Taxes.

Overview of IAS 12 Income Taxes

CURRENT TAX

Amount of income tax payable on taxable profit for a period based on tax law

Measurement	R	Recognition	Dr R	Cr R
Accounting profit	xx	Current tax expense	xx	
Add back:		Liability		xx
Accounting items (e.g. depreciation)	xx	Tax expense is usually in P/L but recognises tax consequence where the item was recognised (P/L, OCI, Equity)		
Include tax treatment (e.g. tax allowance)	xx			
Taxable profit	xx			
Current tax @ 27%	xx			

DEFERRED TAX

Recovery or settlement of carrying amount of assets and liabilities will make future tax payments larger or smaller than they would have been if they had no tax consequence
= recognised deferred tax, with limited exceptions

Carrying amount	-	Tax base	=	Temporary difference		
Some temporary differences are exempt: No deferred tax (show in tax reconciliation in the note)				Taxable Deferred tax liability	Deductible Deferred tax asset (to the extent probable that could be utilised)	
Measurement § Tax rate expected to apply when temporary differences reverse; § based on the manner in which the carrying amount is expected to be recovered or settled.				Recognition Movement in deferred tax balance usually in P/L, but recognises tax consequence where the item was recognised (P/L, OCI, Equity)		Detailed disclosure

VIDEOS



Watch the <https://mymodules.dtls.unisa.ac.za/mod/folder/view.php?id=1340266> discussing deferred taxation.



DISCUSSION FORUM

A general discussion forum has been set up for each topic within this learning unit. It is strongly recommended that you post your questions and comments on the forum as you work through the learning unit. Your lecturers are more than happy to assist you on your learning journey.

The discussion forum for topic 1.3 can be accessed here:
<https://mymodules.dtls.unisa.ac.za/mod/forum/view.php?id=1340265>

TOPIC 1.4

BASIS OF PREPARATION OF FINANCIAL STATEMENTS



INTRODUCTION

The purpose of this standard is to prescribe criteria for the selection of an accounting policy, as well as for the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of prior period errors, to ensure consistent preparation and presentation of financial statements. The standard enhances the comparability of the entity's financial statements with previous periods, as well as with financial statements of other entities.



PRESCRIBED STUDY MATERIAL

IAS 8 Basis of Preparation of Financial Statements

SAICA Student Handbook 2025/2026; Volume1; Part A2

IAS 8 was covered as part of your undergraduate studies. It is important that you revise the study material and concepts if you are not familiar with the content.

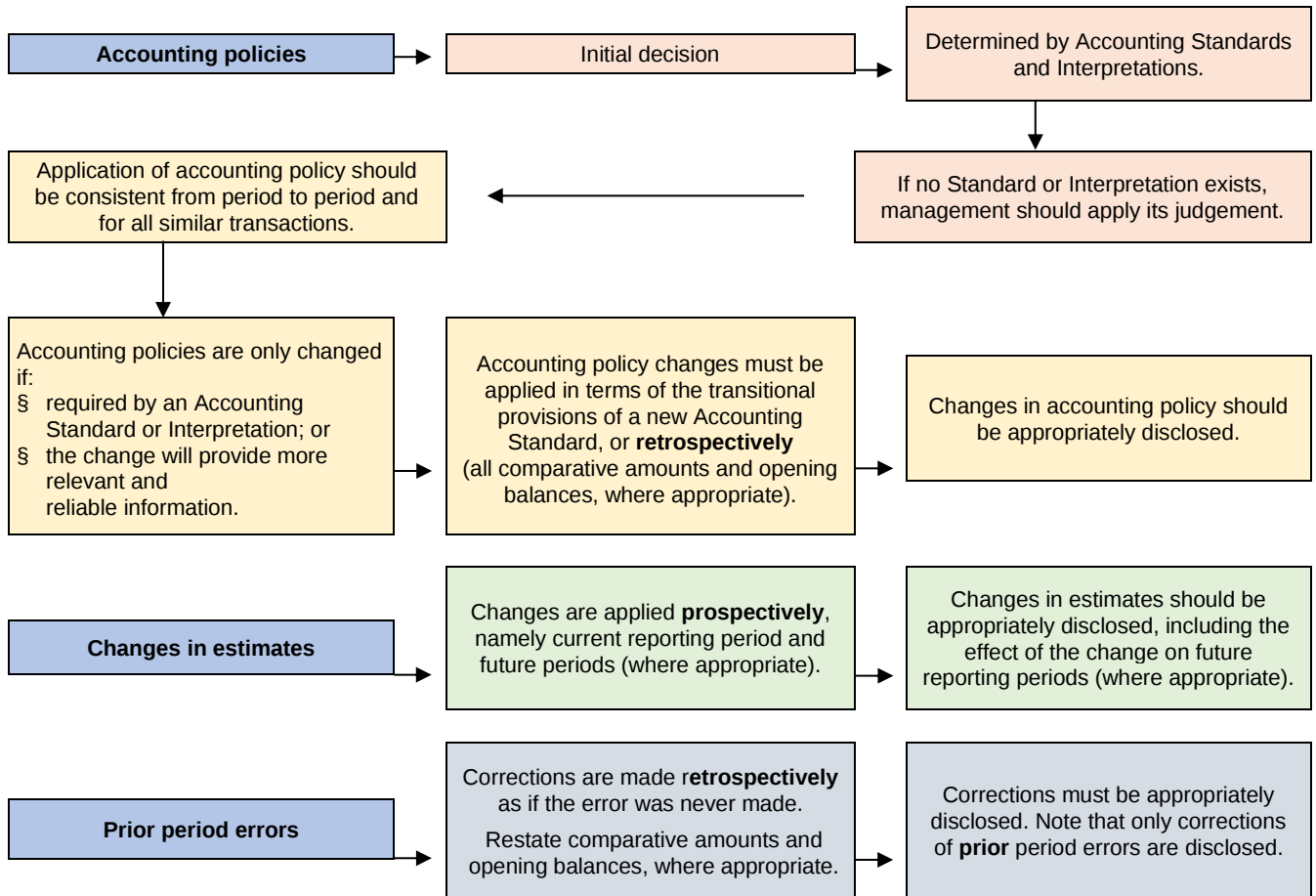
Also note that Unisa follows the limited open-book policy as prescribed by SAICA and that you will be allowed to use the SAICA Student Handbook during assessments.

IAS 8 Basis of Preparation of Financial Statements is assessed on Proficiency **Level 3** (To the extent that it establishes principles for changes in policies and estimates and correction of errors and related disclosures for IFRSs/Topics included in syllabus).

Non-compliance with IFRS, departure from IFRS, initial application of an IFRS Standard and when an entity has not applied a new IFRS are **excluded**.

Let's look at the overview of IAS 8 Basis of Preparation of Financial Statements .

Overview of IAS 8 Basis of Preparation of Financial Statements



DISCUSSION FORUM



A general discussion forum has been set up for each topic within this learning unit. It is strongly recommended that you post your questions and comments on the forum as you work through the learning unit. Your lecturers are more than happy to assist you on your learning journey.

The discussion forum for topic 1.4 can be accessed here:

<https://mymodules.dtls.unisa.ac.za/mod/forum/view.php?id=1340267>

TOPIC 1.5 – FINANCIAL INSTRUMENTS



INTRODUCTION/ PURPOSE

Financial instruments include a wide variety of instruments, including shares, debentures, receivables, payables and derivative instruments (for example share options and forward exchange contracts). The accounting treatment and disclosure of financial instruments are prescribed in three different standards.



PRESCRIBED STUDY MATERIAL

1. **IAS 32 Financial Instruments: Presentation**
2. **IFRS 9 Financial Instruments**
3. **IFRS 7 Financial Instruments: Disclosure**

SAICA Student Handbook 2025/2026; Volume1; Part A2
 SAICA Student Handbook 2025/2026; Volume1; Part A1
 SAICA Student Handbook 2025/2026; Volume1; Part A1

The above standards were covered as part of your undergraduate studies. It is important that you revise the study material and concepts if you are not familiar with the content.

Also note that Unisa follows the limited open-book policy as prescribed by SAICA and that you will be allowed to use the SAICA Student Handbook during assessments.

Description	Level	Notes
IFRS 7 is excluded , except for the following:		
Scope	1	
IAS 32 and IFRS 9 are at Level 3 except for the following:		
Scope (IAS 32, IFRS 9)	1	
Definitions (IAS 31, IFRS 9)		
• POCI purchased originated credit-impaired) financial assets	Excluded	Students should still be able to account for derivatives (e.g., FECs) but not do hedge accounting in compliance with IFRS 9 Chapter 6.
• All definitions relating to hedge accounting	Excluded	
All other definitions	3	
Presentation (IAS 32)		
• Basic classification (apply definitions & consider substance over form)	2	Modifications (Level 1)
• Puttable instruments and obligations arising on liquidation (par. 16A - 16F & 22A)	Excluded	
• Compound financial instruments	2	
• Contracts (options) on own equity instruments	Excluded	
• Treasury shares	2	

Description	Level	Notes
- Interest, dividends, losses and gains (presentation in SPLOCI follows SFP classification) - Offsetting a financial asset and financial liability	2	
Initial recognition (IFRS 9)	2	
Derecognition of financial liabilities (IFRS 9) except for:	2	
Exchange of debt instruments (IFRS 9 par. 3.3.2 & B3.3.6)	1	
Derecognition of financial assets: contractual rights expire (but excluding an assessment of applying the requirements to a part or a whole: see excluded below) (IFRS 9)	2	
Derecognition of financial assets: transfers / continued involvement and applying the requirements to a part or a whole (IFRS 9)	Excluded	
Classification of financial assets and financial liabilities (measurement categories) (IFRS 9) - Embedded derivatives (only pertain to liabilities) (IFRS 9) - Hybrid instrument where the host is not a financial instrument (IFRS 9)	2 Excluded Excluded	The accounting of financial liabilities measured at FVTPL with own credit adjustments in OCI are included at a level 1
Initial measurement (IFRS 9) (link to IFRS 13)	2	
- First-day gains and losses - Regular way purchase or sale of financial assets (trade date and settlement date accounting) (IFRS 9)	1 Excluded	
Subsequent measurement of financial assets and financial liabilities (incl. amortised cost measurement & accounting for derivatives) (IFRS 9)	2	
Financial guarantee contracts	Excluded	
Loan commitments	Excluded	
Extinguishing financial liabilities with equity instruments (IFRIC 19)	2	
Modifications	1	
Write off	1	

Overview of IAS 32 Financial Instruments: Disclosure and Presentation

Definitions

Financial instruments
Financial assets
Financial liability
Equity instrument

Presentation

Liabilities and equities

No contractual obligation to deliver cash or another financial asset

Settlement in the entity's own equity instrument

- **Variable number of its own equity instruments**
- **Fixed number of its own equity instruments**
- **Contracts (options) on own equity instruments**

Contingent settlement provisions

Compound financial instrument

Treasury shares

Interest, dividends, losses and gains

Offsetting a financial asset and a financial liability

Excluded

The following concepts and topics are excluded from the syllabus:

Definitions

- Purchased or originated credit-impaired financial assets
- All definitions relating to hedge accounting

Presentation

- Puttable instruments and obligations arising on liquidation (par. 16A-16F & 22A)

Overview of IFRS 9 Financial Instruments

Definitions

12-month expected credit losses
Amortised cost
Credit impaired financial asset
Credit loss
Derivative
Effective interest rate
Expected credit losses
Financial liability at FVTPL
Gross carrying amount of financial asset
Held for trading
Loss allowance
Modification gain or loss
Transaction costs

Recognition/Derecognition

Initial recognition
- First-day gains and losses
Derecognition of financial assets
Derecognition of financial liability
- Exchange of debt instrument

Classification

Financial assets

- At amortised cost
- At FVTOCI
- At FVTPL

Financial liabilities

- At FVTPL
- Embedded derivatives
Reclassification

Measurement

Initial measurements

Subsequent measurements

- financial assets
- financial liabilities

Amortised cost

- Modifications
- Write offs

Impairments

Recognition of expected credit losses
Identify when significant increase in credit risk or when credit impaired
Modified financial assets
Simplified approach
Measurement of expected credit losses

Reclassification of financial assets

Gains and losses

- Investments in equity instruments
- Liabilities at FVTPL
- Assets at FVTOCI

Excluded

Definitions

- Purchased or originated credit impaired (POCI) financial assets

- All definitions relating to hedge accounting

Initial recognition

- Regular way purchase or sale of financial assets (trade date and settlement date accounting).

Derecognition of financial assets

- Transfers/continued involvement and applying the requirements to a part or a whole

Classification of financial liabilities

- Financial guarantee contracts
- Loan commitments

Embedded derivatives (only pertains to liabilities)

Hybrid instruments where the host is not a financial instrument

Initial measurement

- Regular way purchase or sale of financial assets (trade date and settlement date accounting).

Impairment

- Purchased or originated credit-impaired financial assets

Hedge accounting

Application guidance and Illustrative Examples follow the related levels of the main body in the standard.



DISCUSSION FORUM

A general discussion forum has been set up for each topic within this learning unit. It is strongly recommended that you post your questions and comments on the forum as you work through the learning unit. Your lecturers are more than happy to assist you on your learning journey.

The discussion forum for topic 1.5 can be accessed

here: <https://mymodules.dtls.unisa.ac.za/mod/forum/view.php?id=1340269>

EXAMPLE 3

Complete the following two comprehensive questions.

QUESTION 1

(60 marks/ 120 minutes)

The financial directors of Blue Ltd (Blue) and Pink Ltd (Pink) requested you to explain to them how the following financial instruments should be **classified** in the financial statements of Blue and the financial statements of Pink in terms of IAS 32 *Financial Instruments: Presentation*. All the transactions below occurred during the financial year ended 31 December 20.23.

Transaction 1

On 1 January 20.23 Blue purchased 100 000 shares in Pink. These were acquired at fair value on transaction date.

Transaction 2

On 1 December 20.23 Blue obtained a short-term loan of R20 000 from Pink and is required to **repay** the total loan within 90 days. The loan is still outstanding on 31 December 20.23.

Transaction 3

On 1 December 20.23 Blue obtained a short-term loan of R20 000 from Pink and is required to settle the total loan within 90 days in as many **shares** as equal to R20 000. The loan is still outstanding on 31 December 20.23.

Transaction 4

On 1 December 20.23 Blue issued share options to Pink. The share options entitle Pink to purchase 2 000 ordinary shares in Blue at a price of R2 per share.

Transaction 5

On 31 December 20.23 Blue issued 1 000 redeemable cumulative preference shares to Pink at an issue price of R1 per preference share. The dividend rate is an 8% cumulative preference dividend per annum, calculated on the issue price. All accumulated (unpaid) dividends will roll up until redemption date. The redemption of preference shares will take place on 31 December 20.25 at R1,20 per share.

Transaction 6

On 31 December 20.23 Blue issued 1 000 non-redeemable cumulative preference shares to Pink at an issue price of R1 per preference share. The dividend rate is an 8% cumulative preference dividend per annum, calculated on the issue price. The payment of a preference dividend is solely at the discretion of the directors of Blue.

Transaction 7

On 31 December 20.23 Blue issued 1 000 cumulative compulsory convertible preference shares to Pink at an issue price of R1 per preference share. On 31 December 20.25, the conversion date, each preference share will automatically be converted into two ordinary shares. The dividend rate is an 8% cumulative preference dividend per annum calculated on the issue price. All accumulated (unpaid) dividends will roll up until the conversion date.

Transaction 8

On 1 January 20.23 Blue issued 500 debentures to Pink. Each debenture will be converted into one ordinary share on 1 January 20.25 if the revenue of Blue increases by more than 8% per annum. If the increase in Blue's revenue is less than 8% per annum, the debentures will be redeemed in cash on 1 January 20.25.

Transaction 9

On 1 January 20.23 Blue has 80 000 ordinary shares in issue which were originally issued at R5 each. On 1 July 20.23 10 000 of the ordinary shares were bought back from Pink at R6 per share.

REQUIRED

	Marks
Provide an explanation to the financial directors of Blue Ltd and Pink Ltd of how the above-mentioned financial instruments should be classified in their respective financial statements for the year ended 31 December 20.23, in accordance with IAS 32 <i>Financial instruments: Presentation</i>. Please note: • You are not required to include calculations in your explanation. • Ignore the effect of the time value of money in the scenarios above. • Ignore any normal income tax implications. • Ignore any Value Added Tax (VAT) implications. • Your answer must comply with IFRS Accounting Standards.	60

QUESTION 1 - Suggested solution

PART A

Transaction 1

Blue's financial statements (investor):

The investment in shares will be classified as a **financial asset**, since Blue holds the equity instrument of another entity (IAS 32.11). (1)

Pink's financial statements (issuer):

The shares issued will be classified as **equity instruments**, since it is a contract which evidences a residual interest in the assets of Pink after deducting its liabilities (IAS 32.11). (1)

Transaction 2

Blue's financial statements:

A loan payable will be recognised as a **financial liability**, since Blue has a **contractual obligation** to deliver **cash** to Pink within 90 days (IAS 32.11). (1)

Pink's financial statements:

A loan receivable will be recognised as a **financial asset** in the records of Pink since it represents a **contractual right** to receive **cash** from Blue (IAS 32.11). (1)

Transaction 3

Blue's financial statements:

In terms of the agreement, Blue has **no contractual obligation** to deliver **cash** or another **financial asset** to settle the loan. (1)

Blue is, however, required to settle the loan with its **own shares (equity instruments)**. It is important to note that the fact that Blue is required to deliver its own equity instruments **does not automatically** classify the loan as an equity instrument (IAS 32.21). (1)

It is essential to determine the **substance of the contract**. In other words, is the number of shares to be issued by Blue in terms of the contract fixed or variable (IAS 32.21). (1)

The amount that Blue needs to settle remains fixed at R20 000. However, the number of shares that Blue will need to deliver to settle the loan **varies** (the number of shares issued on delivery date is dependent on the share price of the ordinary shares). (1)

The contract will, therefore, be settled by delivering a **variable number** of Blue's own shares in exchange for a fixed amount. Accordingly, the loan payable is a **financial liability** (IAS 32.11). (1)

Pink's financial statements:

A loan receivable will be recognised as a **financial asset**, since it meets the definition of a financial asset (Pink receives an equity instrument from another entity) (IAS 32.11). (1)

Transaction 4

Blue's financial statements (issuer):

Blue has **no contractual obligation** in terms of the option contract to deliver **cash** or another **financial asset** to Pink. (1)

The issued share options, however, give Pink the right to buy a **fixed number** of Blue's shares (2 000 ordinary shares) at a **fixed price** (R2 per ordinary share) (IAS 32.16 and IAS 32.22). (1)

Accordingly, the share options issued by Blue are **equity instruments** in accordance with IAS 32.22. (1)

Pink's financial statements (holder):

The share options meet the definition of a **derivative** (IAS 32.AG15 and IFRS 9 Appendix A) from Pink's perspective. The investment in the shares will only be recognised as a financial asset of (1)

Pink when the share options are exercised (IAS 32.AG17). (1)

Transaction 5

Blue's financial statements (issuer):

Blue should consider the **two cash flow streams** (components) related to preference shares (i.e., the payment of preference **dividends** and the payment of the **principal** amount) separately for classification purposes. (1)

Principal amount

When assessing the substance of the agreement between Blue and Pink, it is clear that Blue has a **contractual obligation** to deliver **cash to Pink** on 31 December 20.25 (the preference share agreement contains a **mandatory** redemption feature) (IAS 32.18(a)). (1)

The principal amount is classified as a **financial liability**. (1)

Dividends

It has to be determined if Blue has a **contractual obligation** to make dividend payments to assess if the dividend component of this agreement is equity or a financial liability. (1)

Cumulative dividends accumulate (accrue) if the company does not earn sufficient profits to declare and pay a preference dividend i.e., if the dividend is not declared in one year it will be carried forward to successive years. (1)

Since this preference share agreement contains a **redemption feature**, all accumulated (unpaid) dividends will roll up until redemption date and will have to be paid on 31 December 20.25 when the preference shares are redeemed. (1)

Therefore, based on the substance of this transaction, Blue has a **contractual obligation** to declare and pay all preference dividends on or before 31 December 20.25. (1)

In light of the above the preference dividends are classified as a **financial liability**. (1)

Conclusion

The preference shares are classified as a financial liability (IAS 32.11 and IAS 32.18a). (1)

Take note that the dividends paid to Pink will be recognised in profit or loss as finance costs since the classification of the financial instrument determines how the related payment will be treated in the financial statements. (1)

Pink's financial statements (holder)

The investment in the preference shares will be classified as a **financial asset** in the records of Pink. (1)

Transaction 6

Blue's financial statements (issuer):

As with the above transaction, if we evaluate the **two cash flow streams** related to preferences shares, we can conclude the following: (1)

Principal amount

Non-redeemable preference shares are preference shares that do not have a maturity date and will, therefore, **not be bought back** by the issuer (Blue) (also known as perpetual preference shares). This feature makes non-redeemable preference shares very similar to **equity**. (1)

Dividends

The cumulative dividends accumulate (accrue) if the company does not earn sufficient profits to declare and pay a preference dividend. (1)

Since the non-redeemable preference shares do not contain a redemption obligation and the payment of preference dividends are at the directors' discretion, the preference shares establish **no contractual right** to a preference dividend (IAS 32.AG26). (1)

Accordingly, the preference dividends are similar to ordinary dividends (equity). (1)

Conclusion

Accordingly, the preference shares should be classified as equity instruments. (1)

Pink's financial statements (holder):

The investment in the preference shares will be classified as a **financial asset** in the records of Pink, since it is an equity instrument of another entity. (1)

Transaction 7

Blue's financial statements (issuer):

The **two cash flow streams (components)** related to preferences shares (i.e., the payment of preference **dividends** and the payment of the **principal** amount) are considered separately for classification as equity or a financial liability (IAS 32.28). (1)

Principal amount

The substance of this agreement between Blue and Pink contains a **compulsory conversion feature** that will force Blue to convert the preference shares into ordinary shares on 31 December 2025. (1)

Therefore, in terms of the agreement, Blue has **no contractual obligation** to deliver **cash** or a **financial asset** to Pink on the conversion date. (1)

Blue is, however, required deliver its **own shares (equity instruments) to Pink on the conversion date**. (1)

The substance of the contract determines that Blue has to deliver a **fixed number** of ordinary shares to Pink on the conversion date (20 000 ordinary shares). (1)

In light of the above, the principal amount is classified as an **equity instrument**. (1)

Dividends

It has to be determined if Blue has a **contractual obligation** to make dividend payments to assess if the dividend component of this agreement is equity or a financial liability. (1)

Since this preference share agreement contains a **compulsory conversion feature**, all accumulated (unpaid) dividends will roll up until conversion date and will have to be paid on 31 December 20.25 when the preference shares are converted. (1)

Therefore, based on the substance of this transaction, Blue has a **contractual obligation** to declare and pay all preference dividends on or before 31 December 20.25. (1)

In light of the above, the preference dividends are classified as a **financial liability**. (1)

Conclusion

The preference shares are classified as a **compound financial instrument** as it contains both an equity and a liability component (IAS 32.28). (1)

This would lead to a “split accounting” treatment, whereby at issue date the net present value of the amount payable to Pink will be classified as a liability and the balance of the proceeds received on issue date will be classified as equity (IAS 32.32). (1)

Pink's financial statements (holder)

The investment in the preference shares will be classified as a **financial asset** in the records of Pink, since it is a contractual right to receive cash or another financial asset. (1)



DISCUSSION

If the convertible preference shares are not compulsory convertible, but convertible at the **option of the holder** at any time up to maturity, the preference shares will still be classified as a **compound financial instrument** for the following reasons:

- Blue has a contractual obligation to declare and pay all accumulated preference **dividends** when Pink exercises its option to convert to ordinary shares (financial liability component).
- If Pink does not exercise its option to convert to ordinary shares, Blue will have to **redeem** the preference shares on 31 December 20.25 (financial liability component).
- Pink has a call option (the right to exchange the preference shares for a **fixed number of ordinary shares**) at any time before maturity date (equity component).

Transaction 8

Blue's financial statements (issuer):

The obligation attached to the debentures (settling in cash or by issuing equity instruments) is dependent on the **occurrence or non-occurrence** of uncertain future events. (1)

It has to be determined if the uncertain future event (the rise in future revenue) is within the **control** of Blue and Pink. (1)

In terms of IAS 32.25 the issuer's future revenues are **not within the control** of the **issuer** and the **holder**. (1)

In light of this, Blue does not have an unconditional right to avoid delivering cash on the maturity date. (1)

Therefore, the debentures are classified as a **financial liability** in terms of the contingent settlement provisions of IAS 32.25. (1)

Pink's financial statements (holder):

The investment in the debentures will be classified as a **financial asset** in the records of Pink, since Pink has a contractual right to receive cash. (1)

Transaction 9

Blue's financial statements:

Blue reacquired its own equity instruments and should classify them as treasury shares (IAS 32.33). (1)

In terms of South African legislation, the shares reacquired by Blue must be cancelled as issued share capital. (1)

An amount equal to the **initial** proceeds of the shares (10 000 x R5 = R50 000) is debited to the share capital account in Blue's financial statements. (1)

No gain or loss is recognised in profit or loss on the share buy-back. (1)

The remaining R10 000 (R60 000 – R50 000) is debited to any available equity reserve in Blue's financial statements (including retained earnings) (IAS 32.33). (1)

Pink's financial statements:

Before the share buy-back, the investment in equity instruments is classified by Pink as a financial asset. The share buy-back transaction is accounted for as a disposal of a financial asset by Pink.

(1)
Total (60)

QUESTION 2

(75 marks/ 150 minutes)

During the year ended 28 February 20.23 Fincor Ltd entered into the following transactions:

Transaction 1

On 1 March 20.22 the company acquired an investment in Bamboo Ltd, a listed company, for share trading purposes. On this date 25 000 ordinary shares were acquired at R12,00 per share. Transaction costs paid by Fincor Ltd amounted to R1 200. The transaction costs are included in the base cost of the shares in terms of the Eighth Schedule to the Income Tax Act. On 28 February 20.23 the market value of the shares was R23,25 per share.

Transaction 2

On 30 June 20.22 Fincor Ltd purchased 15 000 ordinary shares in Brick (Pty) Ltd, an unlisted company, at R12,00 per share. The shares were purchased as a long-term investment. Costs associated with the transaction amounted to R1 800 and are included in the base cost of the shares in terms of the Eighth Schedule to the Income Tax Act. On 28 February 20.23 the shares were valued by the directors at R13,50 per share.

The management of Fincor (Ltd) irrevocably elected in terms of IFRS 9.5.7.5 to present subsequent changes in the fair value of the investment in Brick (Pty) Ltd in other comprehensive income.

Transaction 3

On 1 August 20.22 Fincor Ltd disposed of an investment in Dodgeball Ltd at a fair value of R160 000. The costs related to the disposal of the investment amounted to R1 500. The investment in Dodgeball Ltd was an investment in equity shares and was not held for share trading purposes. The management of Fincor Ltd irrevocably elected on initial recognition to designate this investment as a financial asset at fair value through other comprehensive income in terms of IFRS 9.5.7.5. The carrying amount of the investment in Dodgeball was R150 000 on 1 March 20.22.

Transaction 4

Convertible debentures amounting to a fair value of R250 000 were issued by Fincor Ltd on 1 March 20.22. The debentures have a nominal value of R2 per debenture and pay interest at 14% per annum in arrears on 28 February until conversion. The debentures are convertible into ordinary shares with a nominal value of R2 each, at a ratio of one share for one debenture, at the option of the debenture holders at any time before 28 February 20.27. The market interest rate for similar instruments without conversion rights is 16%.

Transaction 5

On 1 September 20.22 Fincor Ltd issued 5 000 compulsory convertible debentures with a face value of R80 per bond. The debentures are compulsory convertible on 1 September 20.25 into two ordinary shares for every debenture held. A market related interest rate of 6% on the debentures is payable annually in arrears. The market interest rate for similar instruments without conversion rights is 8%.

Transaction 6

On 1 March 20.22 Fincor Ltd purchased bonds in Pear Ltd at a discount of 10% of the face value when market interest rates on similar instruments were 16,3493% per annum. The total face value of the investment in bonds is R200 000. A coupon rate of 12% per annum is payable in arrears on 30 August and 28 February. The bonds will be repaid on 28 February 20.25 at face value. Transaction costs paid by Fincor Ltd amounted to R2 000. The investment in bonds is held within a business model with the objective to collect contractual cash flows of interest and principal.

On 1 March 20.22 Fincor Ltd assessed the probability that Pear Ltd might default on payments and estimated the 12-month expected credit losses on the bonds to be R2 000. On 28 February 20.23 there was no significant deterioration in the credit quality of Pear Ltd and the 12-month expected credit losses on the bonds were estimated to be R2 500.

Transaction 7

On 1 March 20.22 Fincor Ltd purchased bonds in Apple Ltd at a discount of 10% of the face value when market interest rates on similar instruments were 16,3493% per annum. The total face value of the investment in bonds is R200 000. A coupon rate of 12% per annum is payable in arrears on 30 August and 28 February. The bonds will be repaid on 28 February 20.25 at face value. Transaction costs paid by Fincor Ltd amounted to R2 000. The investment in bonds is held within a business model whose objective is to collect contractual cash flows and sell the bonds. In other words, both collecting contractual cash flows and selling the debentures are integral to achieving the business model.

On 1 March 20.22 Fincor Ltd assessed the probability that Apple Ltd might default on payments and estimated the 12-month expected credit losses on the bonds to be R 2 000. At 28 February 20.23 there was no significant deterioration in the credit quality of Apple Ltd and the 12-month expected credit losses on the bonds were estimated to be R 2 500. The total investment in bonds was sold at 28 February 20.23 for cash at its fair value of R180 000.

Transaction 8

On 1 March 20.22 Fincor Ltd acquired an investment in listed bonds of Tradex Ltd. Fincor Ltd's objective with the investment was to hold the assets in terms of a business model to collect contractual cash flows of interest and principal. The bonds will mature at the end of four years when the principal amount of R1 000 000 will be received. The coupon rate is 10% per annum payable in arrears, whereas a market related interest rate on similar bonds is 11% per annum.

On 1 March 20.22 Fincor Ltd assessed the probability that Tradex Ltd might default on payments and estimated the 12-month expected credit losses on the bonds to be R2 000. At 28 February 20.23 there has been no significant deterioration in the credit quality of Tradex Ltd and the 12-month expected credit losses on the bonds is estimated to be R2 500 on reporting date.

On 1 September 20.22 Fincor Ltd purchased a large investment banking operation. As a result of the purchase, Fincor Ltd combined its debt investment with the new banking investment portfolio. The investment banking portfolio has the objective of collecting contractual cash flows and realising fair value gains through sale, which is also now the business model of the debt investment portfolio held by Fincor Ltd. In other words, both collecting contractual cash flows and selling the bonds are integral to achieving the business model.

Transaction 9

Fincor Ltd has a portfolio of trade receivables of R5 430 000 at 28 February 20.23 and only operates in one geographical region. The trade receivables do not have a significant financing component in accordance with IFRS 15 *Revenue from Contracts with Customers*. To determine the expected credit losses for the trade receivables, Fincor Ltd uses a provision matrix. The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. Fincor Ltd uses the following provision matrix:

	Current	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due
Default rate	0,3%	1,1%	3,1%	6%	13%

The age analysis of the trade receivables is as follows:

	Gross carrying amount R
Current	4 072 500
1-30 days past due	543 000
31-60 days past due	362 000
61-90 days past due	271 500
More than 90 days past due	181 000
Total	5 430 000

Transaction 10

Fincor Ltd borrowed R98 500 cash from Blair Bank Ltd on 1 March 20.22. The loan is repayable in four equal instalments of R33 475 at the end of each year.

On 28 February 20.23, after paying the first instalment, Fincor Ltd was able to renegotiate the terms of the loan payable in order to improve its cash position for the next three years. Fincor Ltd issued 10 000 of its own ordinary shares as full and final settlement of the loan payable. The quoted price (level 1 input) of one Fincor Ltd share on 28 February 20.23 amounted to R8,00.

Additional information

1. Assume a normal tax rate of 27% and a capital gains tax inclusion rate of 80%.
2. SARS will not allow impairment losses (expected credit losses) on the bonds as a deduction for income purposes.
3. There are no temporary differences other than those evident from the above-mentioned information. The deferred tax balance on 1 March 20.22 was Rnil.
4. You may assume that none of the financial assets or financial liabilities (other than those indicated as such) was designated to a specific category.

REQUIRED

	Marks
(a) Provide all the journal entries in the records of Fincor Ltd since acquisition or issue date of the financial instrument until 28 February 20.23 for transactions 1 to 8. Please note: • Journal narrations are not required. • Ignore any normal income tax implications. • Round off all amounts to the nearest rand. • Round off all calculated effective interest rates to four decimals. • Your answer must comply with IFRS Accounting Standards.	61
(b) Provide the journal entries in the records of Fincor Ltd to account for the loss allowance on the trade receivables (transaction 9) for the year ended 28 February 20.23 and the settlement of the loan from Blair Bank Ltd (transaction 10) on 28 February 20.23.	9
(c) Calculate the deferred tax balance on 28 February 20.23 of transactions 1 to 3. Please note: • Round off all amounts to the nearest rand. • Ignore any Value Added Taxation (VAT) implications. • Your answer must comply with IFRS Accounting Standards.	5

QUESTION 2 - Suggested solution

- (a) Provide all the journal entries in the records of Fincor Ltd since acquisition or issue date of the financial instrument until 28 February 20.23 for transactions 1 to 8.

		Dr R	Cr R	
TRANSACTION 1				
1 March 20.22				
J1	Financial asset at fair value through P/L (SFP)			
	(25 000 x R12,00)	300 000		(1½)
	Transaction costs (P/L)	1 200		(½)
	Bank (SFP)		301 200	(½)
	Recognise investment and expense transaction costs			
28 February 20.23				
J2	Financial asset at fair value through P/L (SFP)			
	[(25 000 x R23,25) – 300 000]	281 250		(1½)
	Fair value adjustment (P/L)		281 250	(½)
	Remeasure investment to fair value at year end			
				<u>(4½)</u>



DISCUSSION

This investment in equity instruments is classified as a financial asset at fair value through P/L. The purpose for the acquisition (i.e., trading or long term) does not impact on the **classification** of the financial asset in terms of IFRS 9 (it does, however, have an impact on the tax rate applied for deferred tax purposes). Take note **transaction costs** are **expensed** and not included in the carrying amount of the investment in terms of IFRS 9.5.1.1.

TRANSACTION 2

30 June 20.22				
J1	Financial asset at fair value through OCI (SFP)	181 800		(½)
	Bank (SFP) [(15 000 x 12,00) + 1 800] (SFP)		181 800	(1½)
	Recognise investment and capitalise transaction costs			
28 February 20.23				
J2	Financial asset at fair value through OCI (SFP)			
	[(15 000 x 13,50) – 181 800]	20 700		(1½)
	Mark-to-market reserve (OCI)		20 700	(½)
	Remeasure investment to fair value at year end			
				<u>(4)</u>



DISCUSSION

This investment is classified as a financial asset at fair value through **OCI**, since the management of Fincor (Ltd) made the **election** in terms of IFRS 9.5.7.5. Take note that management may only make this election if the investment is in an **equity instrument** and if it is **not held for trading**.

		Dr R	Cr R	
TRANSACTION 3				
1 August 20.22				
J1	Financial asset at fair value through OCI (SFP) (160 000 – 150 000)	10 000		(1)
	Mark-to-market reserve (OCI)		10 000	(½)
	Remeasurement of investment to fair value on date of sale			
J2	Bank (SFP) (160 000 – 1 500)	158 500		(1)
	Selling expenses (P/L)	1 500		(1)
	Financial asset at fair value through OCI (SFP)		160 000	(½)
	Sale of investment in Dodgeball			
				<u>(4)</u>



DISCUSSION

The investment is revalued to its new fair value on the selling date (**prior to derecognition**). The fair value gains/losses on the investment in Dodgeball are recognised in other comprehensive income, but the **selling expenses** are recognised in profit or loss. The cumulative fair value gains/losses presented in OCI through the mark-to market reserve **may** not be transferred to profit/loss on selling date (IFRS 9 B5.7.1). However, Fincor may transfer the cumulative fair value gains/losses within **equity** (to retained earnings for instance) (IFRS 9 B5.7.1).

TRANSACTION 4

1 March 20.22				
J1	Bank (SFP)	250 000		(½)
	Liability component of convertible debentures (SFP) [C1]		233 629	(2)
	Equity component of convertible debentures (SCE) [C1]		16 371	(½)
	Recognise the convertible debentures issued			
28 February 20.23				
J2	Finance costs (P/L) [C1]	37 381		(1)
	Bank (SFP)		35 000	(½)
	Liability component of convertible debentures (SFP)[C1]		2 381	(½)
	Recognise effective interest and interest paid			
				<u>(5)</u>

CALCULATIONS

C1. Convertible debentures

Calculation of present value of liability component

N	=	5	[½]
I	=	16% (market interest rate)	[½]
PMT	=	35 000 (250 000 x 14%) (coupon rate)	[½]
FV	=	250 000	[½]
PV	=	233 629	

Financial liability (PV of interest and principal amount)	233 629	
Equity component (balancing figure)	16 371	[½]
Proceeds of the debenture issue	<u>250 000</u>	

Amortisation table

	Opening balance	Effective interest fixed at 16%	Interest coupon	Closing balance (gross carrying amount)
	R	R	R	R
Year ended 28 February 20.23	233 629	37 381	(35 000)	236 010

[1½]

[4]

Effective interest can also be calculated with “1 amort” on the HP or SHARP calculator.



DISCUSSION

- From Fincor’s perspective the convertible debentures represent a **compound instrument** and comprise two components: a **financial liability** (a contractual obligation to deliver cash in the form of interest and principal) and an **equity instrument** (option granting the holder the right to convert the debentures into a **fixed** number of ordinary shares of Fincor).
- The financial liability component of the convertible debentures is measured at **amortised cost** using the effective interest rate method in terms of IFRS 9.
- It should be noted that it is **not** important **which party has the option** to convert the debentures into ordinary shares. The issuer’s obligation to make payments of **interest** and **principal** exists as long as the instrument is not converted (irrespective of which party holds the option to convert).

TRANSACTION 5

1 September 20.22

J1	Bank (SFP) (5 000 x R80)	400 000		(½)
	Liability component of convertible debentures (SFP) [C1]		61 850	(2½)
	Equity component of convertible debentures (SCE) [C1]		338 150	(1)
	Recognise the convertible debentures issued			

28 February 20.23

J2	Finance costs (P/L) [C2]	2 474		(1)
	Liability component of convertible debentures (SFP)			
	(balancing)		2 474	(½)
	Recognise effective interest accrued for 20.23			

(5½)

CALCULATIONS

C1. Compulsory convertible debentures

Calculation of present value of liability component

N	=	3	[½]
I	=	8% (market interest rate)	[½]
PMT	=	24 000 (400 000 x 6%) (coupon rate)	[½]
FV	=	0	[½]
PV	=	61 850	<u>[2]</u>

Financial liability (PV of interest)	61 850	
Equity component (balancing figure)	<u>338 150</u>	[1]
Proceeds on the debenture issue (5 000 x R80)	<u>400 000</u>	



DISCUSSION

- The substance of this agreement is a **compulsory conversion feature** that will force Fincor to convert the convertible debentures into ordinary shares on 1 September 20.25. Therefore, Fincor has **no contractual obligation** to deliver **cash** or a **financial asset** to debenture holders on conversion date.
- Fincor is, however, required to deliver its **own shares (equity instruments)** to debenture holders on conversion date. The substance of the contract determines that Fincor has to deliver a **fixed number** of ordinary shares to debenture holders on conversion date. Accordingly, the principal amount contains an **equity instrument**.
- Fincor has a **contractual obligation** to make interest payments up until the conversion date of the bonds. The future interest payments are a **financial liability**.
- In light of the above, the convertible debentures are classified as a compound financial instrument.
- Please take note that since the conversion of the debentures into shares is compulsory, the liability component of the compound financial instrument is only represented by the future interest payments.**

C2. Accrued interest on debentures

Effective interest (61 850 x 8% x 6/12) 2 474 [2]

	Dr R	Cr R	
TRANSACTION 6			
1 March 20.22			
J1 Financial asset at amortised cost: bonds (SFP)			
(180 000 [C1] + 2 000)	182 000		(3)
Bank (SFP)		182 000	(½)
Recognise investment and capitalise transaction costs			
J2 Impairment loss (P/L)	2 000		(1)
Allowance for expected credit losses (SFP)(given)		2 000	(½)
Recognition of 12-month expected credit loss			

		Dr R	Cr R	
	30 August 20.22			
J3	Bank (SFP) [C2]	12 000		(1)
	Financial asset at amortised cost: bonds (SFP)			
	(balancing)	2 457		(½)
	Interest income (P/L) [C2]		14 457	(1)
	Recognise effective interest income and coupon interest received			
	28 February 20.23			
J4	Bank (SFP) [C2]	12 000		(1)
	Financial asset at amortised cost: bonds (SFP)			
	(balancing)	2 652		(½)
	Interest income (P/L) [C2]		14 652	(1)
	Recognise effective interest income and coupon interest received			
J5	Impairment loss (P/L)	500		(1)
	Allowance for expected credit losses (SFP)			
	(2 500 (given) – 2 000 [J2])		500	(1)
	Adjust allowance for expected credit losses			
				<u>(12)</u>

CALCULATIONS

C1. Present value of financial asset at amortised cost: bonds

N	=	6	[½]
I	=	16,3493% per annum (set HP on 2 P/Y; SHARP = 16,3493/2 = 8,1747)	[½]
PMT	=	12 000 (200 000 x 12% x 6/12)	[½]
FV	=	200 000	[½]
PV	=	-180 000	
			<u>[2]</u>



DISCUSSION

- The present value of the investment in bonds is R180 000, which is equal to the amount paid by Fincor Ltd (R200 000 x 90%).
- The credit risk on the bonds did not increase significantly since initial recognition and, therefore, an allowance for expected credit losses equal to 12-month expected credit losses is recognised at the reporting date (28 February 20.23).

C2. Effective interest rate on financial at amortised cost: bonds after transaction costs were capitalised

N	=	6	
PV	=	-182 000 (180 000 + 2 000)	[½]
PMT	=	12 000 (200 000 x 12% x 6/12)	
FV	=	200 000	
I	=	15,8870% per annum (HP) (SHARP 7.94% for 6 months)	[½]

Amortisation table for financial asset at amortised cost: bonds

	Gross carrying amount Opening balance R	Effective interest fixed at 15,8870% p.a. R	Interest coupon R	Gross carrying amount Closing balance R
Six months ended 30 August 20.22	182 000	14 457	(12 000)	184 457
Six months ended 28 February 20.23	184 457	14 652	(12 000)	187 109



EXAM TECHNIQUE

The effective interest is 15,8870% per annum. The effective interest rate for six months is 7,9435% (15,8870% x 6/12). The effective interest income can be calculated on the **gross carrying** amount for the six months ended 30 August 20.22 as follows:

- $182\,000 \times 15,8870\% \times 6/12 = 14\,457$.
- $182\,000 \times 7,9435\% = 14\,457$; or
- using the Amort function.

To save time in the exam or test situation, the student can indicate the calculation of interest as per the calculations indicated above, instead of writing out an amortisation schedule which can be time consuming.

		Dr R	Cr R	
TRANSACTION 7				
1 March 20.22				
J1	Financial asset at fair value through OCI: bonds (SFP) (200 000 x 90%) + 2 000 (given)) Bank (SFP)	182 000	182 000	(3) ($\frac{1}{2}$)
	Recognise investment and capitalise transaction costs			
J2	Expected credit losses (P/L) Expected credit loss reserve (OCI)	2 000	2 000 ¹	(1) ($\frac{1}{2}$)
	Recognition of 12-month expected credit loss			
30 August 20.22				
J3	Bank (SFP) (200 000 x 0,12 x 6/12) Financial asset at fair value through OCI: bonds (SFP) (balancing)	12 000 2 457	14 457	(1) ($\frac{1}{2}$) (1)
	Interest income (P/L) [C2 transaction 6] Recognise effective interest income and coupon interest received			
28 February 20.23				
J4	Bank (SFP) [C2] Financial asset at fair value through OCI: bonds (balancing) (SFP)	12 000 2 652	14 652	(1) ($\frac{1}{2}$) (1)
	Interest income (P/L) [C2 transaction 6] Recognise effective interest income and coupon interest received			
J5	Expected credit losses (P/L) (2 500 – 2 000) Expected credit loss reserve (OCI) (2 500 – 2 000)	500	500	(1) ($\frac{1}{2}$)
	Adjusting of 12-month expected credit loss			
J6	Fair value loss (OCI) Financial asset at fair value through OCI: bonds (SFP) ((182 000 + 2 457 + 2 652) – 180 000 (given))	7 109 ²	7 109	(1) (1)
	Recognition of fair value loss on investment			
J7	Bank (SFP) Financial asset at fair value through OCI: bonds (SFP) Disposal of investment in bonds	180 000	180 000	(1) (1)

		Dr R	Cr R	
J8	Fair value loss (P/L) [J6]	7 109		(1)
	Fair value loss (OCI)			
	Reclassify fair value loss accumulated in equity to profit or loss		7 109	(1)
J9	Expected credit loss reserve (OCI)	2 500		
	Expected credit losses (P/L)			
	(2 000 [J2] + 500 [J5])		2 500	
	Reclassify accumulated impairment amounts in equity to profit or loss on derecognition			
				<u>(17½)</u>



DISCUSSION

- ¹ An expected credit loss reserve is recognised in other comprehensive income when those expected credit losses relate to a financial asset **mandatorily** measured at fair value through other comprehensive income (IFRS 9.4.1.2.A).
- ² The cumulative fair value gain or loss and the expected credit loss reserve recognised in equity via other comprehensive income are reclassified to profit or loss when the financial asset is derecognised.
- ³ The **effective interest income** recognised in 20.23 is calculated using the **original** effective interest on the **gross carrying amount** of the bonds. The gross carrying amount is the amortised cost of a financial asset, **before** adjusting for any **loss allowance**.

TRANSACTION 8

1 March 20.22

J1	Financial asset at amortised cost (SFP)	968 976		(2)
	Bank (SFP)		968 976	(½)
	(FV = 1 000 000; N = 4; I = 11%; PMT 100 000)			
	Initial recognition of investment at fair value (PV)			
J2	Impairment loss (P/L)	2 000		(1)
	Allowance for expected credit losses (SFP)(given)		2 000	(½)
	Recognition of 12-month expected credit loss			

28 February 20.23

J3	Bank (SFP) (1 000 000 x 10%)	100 000		(1)
	Financial asset at amortised cost (SFP)(balancing)	6 587		(1)
	Interest income (P/L) (968 976 [J1] x 11%)		106 587	(1)
	Recognition of effective interest income and coupon interest [J1]			
J4	Expected credit losses (P/L)	500		(1)
	Allowance for expected credit losses (SFP)			
	(2 500 (given) – 2 000 [J2])		500	(½)
	Recognition of 12-month expected credit loss			
				<u>(8½)</u>



DISCUSSION

The change in Fincor's business model will result in the reclassification of the investment at amortised cost to fair value through other comprehensive income. The reclassification will only be effected for accounting purposes on the **reclassification date**, i.e., the first day of the reporting period after the change in the business model occurred (in this case 1 March 20.23). Accordingly, the investment in Tradex will not be reclassified during 20.23. The reclassification will be done on 1 March 20.23 and the journal will be as follows:

	Dr R	Cr R
Financial asset at fair value through OCI (SFP)	975 563	
Financial asset at amortised cost (SFP) (968 976 (J1) + 6 587 (J2))		975 563

Immediately after reclassification the investment is adjusted to the fair value of the investment on the reclassification date. Say the fair value of the investment on 1 March 20.23 was R980 000:

	Dr R	Cr R
Investment Tradex at fair value through OCI (SFP)	4 437	
Fair value adjustment (OCI) (980 000 – 975 563)		4 437
Allowance for expected credit losses (SFP)	2 500	
Expected credit loss reserve (OCI)		2 500

When a financial asset is reclassified out of the amortised cost measurement category and into fair value through other comprehensive income measurement category, the allowance for expected credit losses recognised in the statement of financial position should be derecognised and recognised as an accumulated impairment in other comprehensive income (IFRS 9.B5.6.1(b)).

- (b) Provide the journal entries in the records of Fincor Ltd to account for the loss allowance on the trade receivables (transaction 9) for the year ended 28 February 20.23 and the settlement of the loan from Blair Bank Ltd (transaction 10) on 28 February 20.23.

Transaction 9

	Dr R	Cr R
28 February 20.23		
J1 Expected credit loss (P/L) [C1]	69 233	(3)
Loss allowance on trade receivables (SFP)		69 233 (½)
Recognition of lifetime expected credit losses		<u>(3½)</u>



DISCUSSION

In accordance with IFRS 9.5.5.15, the loss allowance for trade receivables is always measured at an amount equal to the lifetime expected credit losses. A provision matrix can be used to determine the amount of lifetime expected credit losses on trade receivables.

CALCULATIONS

C1. Loss allowance on trade receivables

Provision matrix

	Gross carrying amount R	Default rate	Lifetime expected credit loss allowance R	
Current	4 072 500	0,3%	12 218	[1½]
1-30 days past due	543 000	1,1%	5 973	[1½]
31-60 days past due	362 000	3,1%	11 222	[1½]
61-90 days past due	271 500	6%	16 290	[1½]
More than 90 days past due	181 000	13%	23 530	[1½]
Total	5 430 000		69 233	<u>[2½]</u>

Transaction 10

	Dr R	Cr R
28 February 20.23		
J1 Financial liability at amortised cost (SFP) [C2]	78 344	(3½)
Loss from derecognition of loan payable (P/L) (balancing)	1 656	(1)
Ordinary share capital (SCE) (10 000 x R8,00)		80 000 (1)
Derecognition of loan payable		
		<u>(5½)</u>

C2. Settlement with equity instruments

Effective interest rate

N	=	4 years	[1½]
PV	=	(98 500)	[1½]
PMT	=	33 475	[1½]
FV	=	0	[1½]
I	=	13,522%	

Amortisation table of loan

Date	Opening balance R	Effective Interest fixed at 13,522% R	Interest R	Closing balance R	
31 December 20.23	98 500	13,319	(33 475)	78,344	[1] <u>[3]</u>



DISCUSSION

The issue of an entity's equity instruments to a credit to extinguish all or part of a financial liability is seen as consideration paid. Fincor Ltd will remove the loan payable from its statement of financial position, since the shares were issued as full and final settlement of the loan payable (IFRIC 19).

(c) Calculate the deferred tax balance on 28 February 20.23 of transactions 1 to 3.

	Carrying amount R	Tax base R	Notes	Temporary differences at 100% or 80% R	Deferred tax asset/ (liability) R	
Investment in Bamboo (transaction 1) (25 000 x 23,25); (25 000 x 12,00) + 1 200	581 250	301 200	1	280 050	(75 614)	(2)
Investment in Brick (at 80%) (transaction 2) (15 000 x 13,50); (15 000 x 12) + 1 800	202 500	181 800	2	(16 560)	(4 471)	(2)
Investment in Dodgeball (transaction 3)	-	-		-	-	(1)
						<u>(5)</u>



DISCUSSION

1. Tax base of an asset: Amounts deductible in the future. Take note that 100% of the temporary differences are included in the deferred tax calculation, since the investment is of a speculative nature.
2. Tax base of an asset: Amounts deductible in the future. If the investment is disposed of in the future it will result in capital gains tax. The amount that will be deductible from the proceeds is the tax base of the investment (cost of the investment plus transaction costs). Take note that the capital gains tax inclusion rate of 80% is applied to the deferred tax calculation, as the investment is of a capital nature since it is held for long-term purposes.

TOPIC 1.6 - THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES



INTRODUCTION

The key issues in accounting for the effects of changes in foreign exchange rates are to determine the appropriate exchange rate to be used for the initial and subsequent recognition of foreign currency transactions in the functional currency of the reporting entity, and how to recognise exchange differences that arise on these transactions.

In this learning unit we will focus on foreign currency transactions only. The translation of foreign operations will be dealt with in Learning unit 5.



PRESCRIBED STUDY MATERIAL

IAS 21 The Effects of Changes in Foreign Exchange Rates

SAICA Student Handbook 2025/2026; Volume1; Part A1;

IAS 21 was covered as part of your undergraduate studies. It is important that you revise the study material and concepts if you are not familiar with the content.

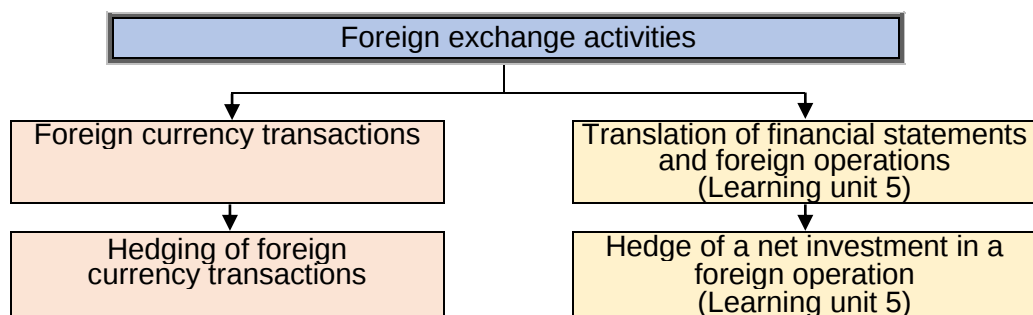
Also note that Unisa follows the limited open-book policy as prescribed by SAICA and that you will be allowed to use the SAICA Student Handbook during assessments.

IAS

Description	Level	Notes
IAS 21 is assessed at proficiency level 3 , except for the following:		
Scope	Excluded	Hyperinflation
	Excluded	Changes in functional currency
	3	See also Groups - Foreign Operations in learning unit 5

Let's look at the overview of IAS 21 The Effects of Changes in Foreign Exchange Rates.

Overview of IAS 21 The Effects of Changes in Foreign Exchange Rates



DISCUSSION FORUM

A general discussion forum has been set up for each topic within this learning unit. It is strongly recommended that you post your questions and comments on the forum as you work through the learning unit. Your lecturers are more than happy to assist you on your learning journey.

The discussion forum for topic 1.6 can be accessed here:

<https://mymodules.dtls.unisa.ac.za/mod/forum/view.php?id=1340270>

EXAMPLE 4

Complete the following question.

QUESTION 1 (20 marks/ 40 minutes)

On 1 September 20.21 Ebenezer Ltd placed a cancellable order amounting to \$120 000 to purchase inventory from a supplier in the USA. The inventory was shipped free on board, at the agreed port of departure. The inventory was delivered to the Port Newark-Elizabeth Marine Terminal, New Jersey, which is the agreed port of departure, on 28 September 20.21. The inventory was loaded on the ship on 28 September 20.21, but the ship only departed to South Africa on 10 October 20.21. Ebenezer obtained control of the inventory on 28 September 20.21.

The debt was payable as follows:

	\$
1 December 20.21	72 000
15 January 20.22	<u>48 000</u>
	<u>120 000</u>

By 31 December 20.21 30% of the inventory was sold on credit, while the other 70% was sold during the year ended 31 December 20.22 for cash. Ebenezer Ltd had no closing inventory on 31 December 20.20 and 31 December 20.22.

The applicable exchange rates were as follows:

	\$1 = R
1 September 20.21	7,70
28 September 20.21	7,78
10 October 20.21	7,74
15 November 20.21	7,71
1 December 20.21	7,80
31 December 20.21	7,72
15 January 20.22	7,85

Additional information

1. Profit before income taxes, before taking the acquisition of the inventory into account, for the years ended 31 December 20.21 and 31 December 20.22, amounted to R1 250 000 and R1 900 000, respectively. The revenue on the sale of the inventory has been correctly recorded.
2. It is the company's policy not to hedge its foreign currency exposure on foreign currency transactions due to the fact that these transactions take place on an ad hoc basis. As a result, Ebenezer Ltd did not take out a forward exchange contract (FEC) to hedge its foreign currency risk on the future payment of the foreign creditor.
3. Assume the time value of money relating to the foreign creditor is not material.

REQUIRED

	Marks
(a) Prepare the journal entries in respect of the above transaction for the years ended 31 December 20.21 and 31 December 20.22.	17
(b) Prepare the profit before income taxes note to the financial statements for the year ended 31 December 20.22 in respect of the above transaction.	3
Please note:	
• Round off all amounts to the nearest rand. • Ignore any normal income tax implications. • Ignore any Value Added Taxation (VAT) implications. • Your answer must comply with IFRS Accounting Standards.	

QUESTION 1 - Suggested solution



DISCUSSION

Drawing a quick timeline can be of great assistance. An example of the timeline for this question is as follows:

	1 Sept 20.21	28 Sept 20.21	1 Dec 20.21	31 Dec 20.21	15 Jan 20.22
SPOT RATE	7,70	7,78	7,80	7,72	7,85
		no entry	P/L ¹	P/L ²	P/L ³



REMEMBER

Foreign currency transactions:

- Record inventory (non-monetary item) and foreign creditor (monetary item) at spot rate on transaction date (IAS 21.21).
- Restate creditor (monetary item) to closing rate at year end or spot rate on settlement date and recognise the foreign exchange differences in P/L (IAS 21.23).

(a) Prepare the journal entries in respect of the above transaction for the years ended 31 December 20.21 and 31 December 20.22.

		Dr R	Cr R	
Year ended 31 December 20.21				
28 September 20.21				
J1	Inventory (SFP) (\$120 000 x 7,78) Creditor (SFP)	933 600	933 600	(1½) (½)
	Record inventory purchased on transaction date			
1 December 20.21				
J2	Foreign exchange difference (P/L) (refer to P/L ¹ on timeline) (\$120 000 x (7,80- 7,78)) Creditor (SFP)	2 400	2 400	(2) (½)
	Remeasure entire creditor to spot rate on date of first payment (loss)			
J3	Creditor (SFP) (\$72 000 x 7,80) Bank (SFP)	561 600	561 600	(1½) (½)
	Make first payment to creditor at spot rate			
31 December 20.21				
J4	Creditor (SFP) (refer to P/L ² on timeline) (\$48 000 x (7,80 – 7,72)) Foreign exchange difference (P/L)	3 840	3 840	(2) (½)
	Remeasure creditor to closing rate at year end (gain)			
J5	Cost of sales (P/L) (R933 600 (refer J1) x 30%) Inventory (SFP)	280 080	280 080	(1½) (½)
	Transfer cost of inventory sold to P/L (cost of sales)			

		Dr R	Cr R	
Year ended 31 December 20.22				
15 January 20.22				
J6	Foreign exchange difference (P/L) (refer to P/L ³ on timeline) (\$48 000 x (7,85 – 7,72)) Creditor (SFP)	6 240	6 240	(2) (½)
	Remeasure creditor to spot rate on date of settlement (loss)			
J7	Creditor (SFP) (\$48 000 x 7,85) Bank (SFP)	376 800	376 800	(1½) (½)
	Final payment to settle creditor at spot rate			
31 December 20.22				
J8	Cost of sales (P/L) (R933 600 x 70%) Inventory (SFP)	653 520	653 520	(1) (½)
	Transfer cost of inventory sold to P/L (cost of sales)			
			Total	<u>(17)</u>

- (b) Prepare the profit before tax note to the financial statements for the year ended 31 December 20.22 in respect of the above transaction.

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NOTES FOR THE YEAR ENDED 31 DECEMBER 20.22

2. Profit before income taxes	20.22 R	20.21 R	
The following items are included in profit before income taxes:			
Income	-	1 440	(1½)
Net foreign exchange gains (J2 and J4 in part (a))			
Expenses	6 240	-	<u>(1½)</u>
Net foreign exchange losses (J6 in part (a))			
		Total	<u>(3)</u>



EXAM TECHNIQUE

Always provide the comparative information in a disclosure question, except if required not to do so.

The treatment of foreign exchange differences corresponds with the treatment of the gain or loss of the underlying non-monetary item. Therefore, the **net** foreign exchange differences will be recognised in profit or loss and the net amount disclosed in the financial statements.

TOPIC 1.7 - SHARE-BASED PAYMENT



INTRODUCTION

Entities often use shares or share options to pay employees and other parties for goods delivered or services rendered. Despite the substantial amounts involved, these transactions are often not accounted for, as it is argued that there is not an outflow of economic benefits. IFRS 2 *Share-based Payment* provides guidance on how these transactions should be dealt with in financial statements.



PRESCRIBED STUDY MATERIAL

IFRS 2 Share-based Payment

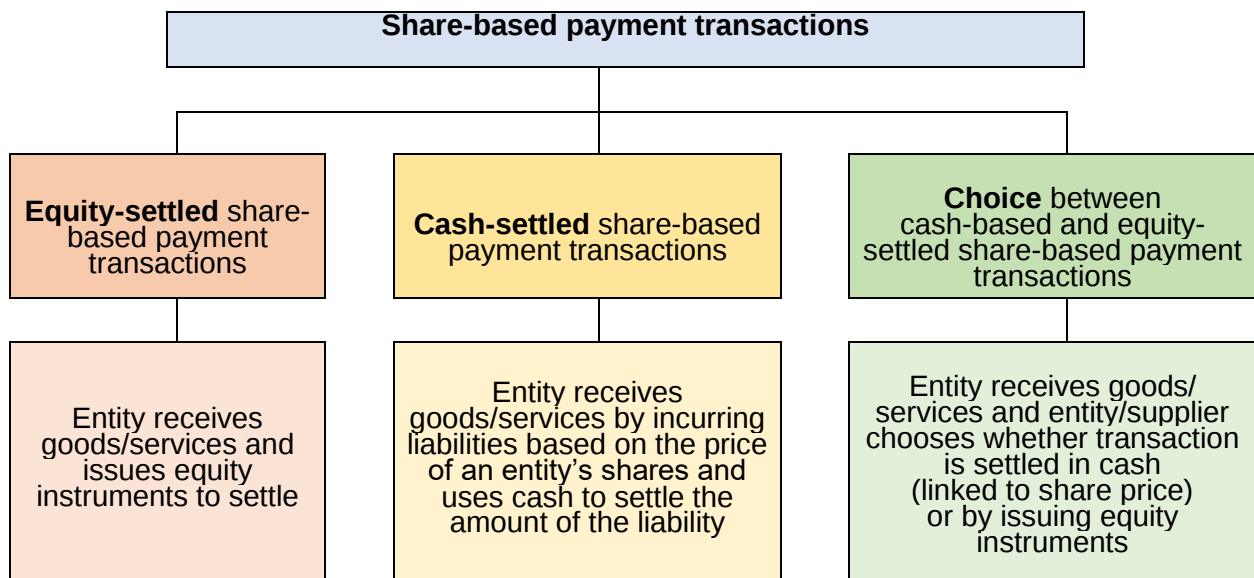
SAICA Student Handbook 2025/2026; Volume1; Part A1

Description	Paragraph	Level	Notes
Objective	1	3	
Scope	2 – 6 5	1 Excluded	Replacement awards (IFRS 3)
Recognition	7 – 9 As applicable in IFRS 2	3 1	Measurement of fair value of options
Equity-settled share-based payment transactions	10 – 13A	3	Overview
	14 – 15	3	Transactions in which services are rendered
	16 - 21	3	Transactions measured by reference to the fair value of the equity instruments granted
	22	Excluded	Treatment of a reload feature
	23 – 25	Excluded	If fair value cannot be determined (intrinsic value method)
	26 – 29	1	Modifications to the terms and conditions on which equity instruments were granted, including cancellations and settlements
Cash-settled share-based payment transactions	30 – 33	3	
	33A – 33D	3	Treatment of vesting and non-vesting conditions
Share-based payment transactions with a net settlement feature for withholding tax obligations	33E – 33H	1	Net settlement after PAYE withheld

Description		Paragraph	Level	Notes
	Share-based payment transactions with cash alternatives	34	3	Share-based payment transactions in which the terms of the arrangement provide the counterparty with a choice of settlement
		35 – 40	1	
		41 - 43	1	
	Share-based payment transactions among group entities	43A	3	
	Disclosures	44 – 52	3	
	Transitional provisions	53 – 59	3	
	Effective date	60 – 63	Excluded	
		Withdrawal of interpretations	64	Excluded
FRG 2 Accounting for Black Economic Empowerment (BEE) Transactions (Included in the SAICA Handbook (Audit Standards; SAICA and IRBA Content))				
Accounting for BEE		1 – 25	3	
Also note that Unisa follows the limited open-book policy as prescribed by SAICA and that you will be allowed to use the SAICA Student Handbook during assessments.				

Let's look at the overview of IFRS 2.

Overview of Share-based payment



VIDEO

Watch the video discussing topic 1.7 share-based payment here:
<https://mymodules.dtls.unisa.ac.za/mod/page/view.php?id=1340272>



DISCUSSION FORUM

A general discussion forum has been set up for each topic within this learning unit. It is strongly recommended that you post your questions and comments on the forum as you work through the learning unit. Your lecturers are more than happy to assist you on your learning journey.

The discussion forum for topic 1.7 can be accessed here: <https://mymodules.dtls.unisa.ac.za/mod/forum/view.php?id=1340271>

EXAMPLE 5

Complete the following question.

QUESTION 1

12 marks/ 24 minutes

IGNORE ALL VALUE-ADDED TAX IMPLICATIONS

You have been recently appointed a financial accountant of Confit Ltd (Confit), a South African-based retail company trading in Southern Africa in over 60 stores. Most of the company's trade is apparel and footwear but they also sell cosmetics, books, stationery, home fashions and general merchandise. You are finalising their financial statements for the financial reporting period ended 31 March 20.25. While reviewing the current financial records the following transaction came to your attention:

Share-based payment

On 1 April 20.22, Confit granted options to acquire 120 ordinary shares of Confit to each of its 170 employees. The strike price of the options was R16 per share, which was equal to the fair value of Confit's ordinary shares on grant date. On grant date the options had a fair value of R12 each.

The options vest only if the employees remain in the employ of Confit for four years after the grant date. At grant date it was anticipated that 28 employees would leave during the vesting period.

During the year ended 31 March 20.23, 11 employees left the company. At 31 March 20.23 it was anticipated that a further 22 employees would leave during the vesting period.

During March 20.24 the market price of Confit's shares plummeted as a result of its operating losses, causing its employees to become demotivated. In order to improve morale of the employees Confit decreased the strike price of the options from R16 to R14 on 31 March 20.24. The fair value of the options before the repricing was R2,50 and after the repricing it was R4,75. There was no change in the vesting period.

During the year ended 31 March 20.24, 8 employees left the company. At 31 March 20.24 it was anticipated that a further 10 employees would leave during the vesting period.

Despite the repricing of the options, the compensation scheme did not achieve its objectives. On 1 October 20.24 the directors and the employees reached an agreement to cancel the option scheme. Two more employees had left since 31 March 20.24, and the fair value of the options was R6,00 each on 1 October 20.24. A total amount of R120 550 was paid to the employees to settle the option scheme.

REQUIRED

	Marks
Prepare the journal entries that Confit Ltd should process in order to record the transactions relating to the share-based payment arrangement in its general journal for the financial year ended 31 March 20.25. Journal narrations are not required and ignore all tax implications.	12

QUESTION 1 - Suggested solution

Prepare the journal entries that Confit Ltd should process in order to record the transactions relating to the share-based payment arrangement in its general journal for the financial year ended 31 March 20.25. Journal narrations are not required and ignore all tax implications.

		Dr R	Cr R	
	1 October 20.24			
J1	Employee benefit costs (P/L) [C2]	153 270		(5)
	Share-based payment reserve (SCE)		153 270	(1)
	Recognition of share-based payment for current year			
J2	Share-based payment reserve (SCE) (149 x 120 x 6)	107 280		(2)
	Staff cost (P/L) (balancing)	13 270		(1)
	Bank (SFP)		120 550	(1)
	Recognition of payment to settle option scheme			
J3	Share-based payment reserve (SCE) (254 790 – 107 280)	147 510		(1)
	Retained earnings (SCE)		147 510	(1)
	Transfer of remaining balance of SBP within equity			
			Total	<u>(12)</u>

CALCULATIONS

C1. Share-based payment expense for March 20.24

$(170 - 11 - 8 - 10) \times 120 \times R12 \times 2/4$

101 520

Modification occurred on 1 October 20.25 = no expense yet

C2. Share-based payment expense for March 20.24

Original $(170 - 11 - 8 - 2) \times 120 \times R12 \times 4/4$

214 560 [1½]

Modification $149 \times 120 \times (R4,75 - R2,5)$

(incremental fair value) $\times 2/2$ (accelerated)

40 230 [1]

254 790

Previous estimate [C1]

(101 520) [2]

153 270

[4½]

INTEGRATED QUESTIONS

Question	Question name	Marks	Topics covered
1	Gasolina (Pty) Ltd	40	Financial Instruments Share-based payments The effects of foreign exchange rates
2	Jota Ltd	25	Disclosure: Income taxes Discussion: Prior year error
3	Lallana Ltd Maiweather Ltd	27	Disclosure: Income taxes Discussion: Presentation and disclosure in financial statements
4	Leo Ltd	35	Financial instruments Presentation and disclosure in financial statements Income taxes
5	Satoshi Ltd	40	Financial instruments The effects of foreign exchange rates Other (Share-based payment)
6	Shantui Construction Ltd	20	Financial instruments The effects of foreign exchange rates
7	Exclusive Clocks Ltd	15	Financial instruments
8	Ultra Motors Ltd	25	Financial instruments The effects of foreign exchange rates
9	ItsAlright Ltd	35	Financial Instruments Foreign exchange transactions Share-based payment
Case study			
1	Mining Ltd	40	The Conceptual Framework for Financial Reporting Income taxes Financial instruments Presentation and Disclosure in financial statements Other (Leases, etc.)

IGNORE VAT

QUESTION 1

40 marks

You are a newly qualified chartered accountant recently appointed as the finance manager at Gasolina (Proprietary) Limited "Gasolina", reporting directly to the chief financial officer (CFO). Gasolina is a private company with a 28 February financial year-end.

Gasolina is based in South Africa and distributes gas and oil; with its primary suppliers located in Europe and the United States. The company has been significantly impacted by the United States sanctions on oil-producing nations. This has led to disruptions in the importation of gas and oil into South Africa because of the decreased global supply.

In response to this crisis, management sought and received approval from the board of directors (board) to apply for mining permits with the Department of Mineral Resources and Energy (DMRE). The permits are for extracting gas and oil along the Wild Coast in the Eastern Cape, as a strategy to enhance shareholder value. The application was successful, and mining rights were granted by the DMRE.

The board approved various capital-raising initiatives to finance the company's new mining operations. Furthermore, a share incentive scheme was introduced to motivate and reward managers for their contributions to the company's growth.

In light of these developments, the CFO has tasked you with preparing the company's financial statements, as he is presently engaged in overseeing Gasolina's strategic initiatives. There are some unresolved issues in the financial statements which require your immediate attention, these are detailed in the matters below.

Matter 1: Convertible debentures

On 1 March 20.24, Gasolina issued 100 000 convertible debentures at a fair value of R200 per debenture, with a maturity period of five years. The debentures carry a coupon rate of 14% per annum paid in arrears. Each debenture is convertible at the option of the holder into one ordinary share in Gasolina.

On 1 March 20.24, the Monetary Policy Committee (MPC) approved a market related interest rate for similar debentures without conversion rights of 2% points per annum above the coupon rate on the issued debenture certificates.

Upon issuing of the debentures, Gasolina paid an amount of R1 200 000, which comprised R400 000 commission fees, R600 000 legal fees and R200 000 bank holding fees.

The South African Revenue Services (SARS) will tax the future taxable profits on the debentures at 27%. Assume that the tax treatment for transactions costs is in line with the accounting treatment as per the applicable IFRS® Accounting Standard.

Matter 2: Share Appreciation Rights (SARs)

On 1 March 20.24, Gasolina entered into an agreement with its directors. According to the agreement, all 10 directors were granted 5 000 share appreciation rights (SARs). At that date, each SARs was equal to one ordinary share of Gasolina.

The SARs will vest on 28 February 20.27, provided that the directors remain in service at Gasolina until that date. The SARs have to be exercised by 28 February 20.28. Gasolina will pay the SARs in cash.

The following fair values were applicable at the respective dates:

Date	Fair value per SAR (R)
01/03/20.24	65
28/02/20.25	72

On 1 March 20.24, it was expected that nine directors would remain in service until 28 February 20.27. The financial accountant of Gasolina did not account for this agreement as she was not clear on the classification of the transaction.

Matter 3: Accounting system error

On 1 March 20.23, Gasolina purchased a bond from the United Kingdom financial market. The bond, which was bought at its fair value (equal to its face value at the time), has a maturity date of 28 February 20.27. The bond carries an annual interest rate of 7%, with the interest paid in arrears at the end of each year. The effective interest rate for a similar bond is 8%.

Gasolina correctly classified this bond at fair value through other comprehensive income.

Upon your review of the general ledger, you noted that since the acquisition of this bond, Gasolina has been translating and recognising coupon payments using the average rate and interest income using the spot rate. The fair value adjustment was correctly calculated.

No journal entry was processed for the bond in the current year.

Details relating to the bond:

Date	Bond	
	Spot rate £1=	Fair value £=
01 March 20.23	18,5	100 000
29 February 20.24	21	125 000
28 February 20.25	23	132 000
Average rate 20.24	16,2	
Average rate 20.25	19,5	

- On 1 March 20.24, retained earnings amounted to R32 600 000, reserves amounted to R4 000 000.
- Profit before income taxes and income tax expense for the year, before taking into account the investment in the bond, amounted to R12 883 521 and R3 478 645 respectively.
- On 28 February 20.25, Gasolina had R8 000 000 share capital; there was no movement in this account since the beginning of the financial year.
- Gasolina declared and paid a dividend of R3 500 000 to the shareholders at the end of the current year.

Additional information:

- The normal income tax rate is 27% and the capital gains tax inclusion rate is 80%.
- Gasolina prepares its financial statements according to IFRS® Accounting Standards.

QUESTION 1

YOU HAVE 80 MINUTES TO ANSWER THIS QUESTION

REQUIRED

	Marks
(a) Provide the journal entries to account for the convertible debenture in the accounting records of Gasolina (Pty) Ltd for the year ended 28 February 20.25. (Matter 1) Please note: - Journal narrations are not required. - Ignore deferred and income tax related journals.	11
(b) Discuss the deferred tax implications arising from the convertible debentures (Matter 1) issued by Gasolina (Pty) Ltd for the year ended 28 February 20.25. Assume that the liability and equity components were R17 755 769 and R1 244 231 respectively, on 1 March 20.24. Please note: Support your discussion with amounts where applicable. <i>X1: Communication skills – clear and concise messaging</i>	9 1
(c) Discuss how the share appreciation rights (SARs) issued by Gasolina (Pty) Ltd should be measured for the year ended 28 February 20.25. (Refer to Matter 2.) Please note: Ignore tax implications. <i>X1: Communication skills – clear and concise messaging</i>	5 1
(d) Present the statement of changes in equity of Gasolina (Pty) Ltd for the year ended 28 February 20.25, incorporating Matter 3 and the additional information only. Please note: - Comparative figures are not required. - The total column is not required. - Distribution to shareholders to be disclose on the statement. <i>X1: Communication skills – presentation</i>	12 1
Please note: - Show and reference all calculations clearly. - Round off all amounts to the nearest Rand. - Your answer must comply with IFRS® Accounting Standards.	
Total	40

Question 1 – Suggested Solution

- (a) Provide the journal entries to account for the convertible debenture in the accounting records of Gasolina (Pty) Ltd for the year ended 28 February 20.25. (Matter 1)

		Dr R	Cr R	
Convertible debentures				
01 March 20.24				
J1	Bank (SFP) [C1.1]	20 000 000		(½)
	Financial liability (SFP) [C1.1]		18 690 283	(2½)
	Equity component (SCE) [C1.1]		1 309 717	(1)
	<i>Recognition of debenture</i>			
J2	Financial liability (SFP) [C1.2]	934 514		(1)
	Equity component (SCE) [C1.2]	65 486		(1)
	Bank (SFP)		1 000 000	(½)
	<i>Capitalised of transaction costs</i>			
	Holding Cost (P/L)	200 000		(1)
	Bank (SFP)		200 000	(½)
	<i>Expense of holding cost</i>			
28 February 20.25				
J3	Interest expense (P/L) [C1.5]	3 116 479		(1½)
	Financial liability (SFP)		316 479	(1)
	Bank (SFP)		2 800 000	(½)
	<i>Alternative to [J3]</i>			
	Interest expense (P/L) [C1.5]	3 116 479		(1½)
	Financial liability (SFP)		3 116 479	(½)
	Financial liability (SFP)	2 800 000		(½)
	Bank (SFP)		2 800 000	(½)
	<i>Recognition of interest</i>			
			Total	<u>(11)</u>

Calculations

C1. Convertible debentures

C1.1 Fair Value of financial Liability component

N	= 5	[½]
I	= 16%	[½]
FV	= (20 000 000) (100 000 x R200)	[½]
PMT	= (2 800 000) (100 000 x R200 x 14%)	[½]
PV	= 18 690 283	

Proceeds (100 000 x R200)	20 000 000	
PV of financial liability	18 690 283	
Equity component (balancing)	1 309 717	[½]
		<u>[2½]</u>

C1.2 Allocation of transaction cost

Liability component (18 690 283 / 20 000 000 x 1 000 000)	934 514	[½]
Equity component	65 486	[½]
	1 000 000	<u>[2]</u>

C1.3 Total value of Liability component

18 690 283 [C1.1] - 934 514 [C1.2]	17 755 769
------------------------------------	------------

C1.4 Total value of equity component

1 309 717 [C1.1] - 65 486 [C1.2]	1 244 231
----------------------------------	-----------

C1.5 New effective interest rate

N	= 5	
PMT	= (2 800 000)	
FV	= (20 000 000)	
PV	= 17 755 769	[½]
I	= 17,55%	
1 Amort Int	= 3 116 479	[½]

(b) Discuss the deferred tax implications arising from the convertible debentures (Matter 1) issued by Gasolina (Pty) Ltd for the year ended 28 February 20.25. Assume that the liability and equity components were R17 755 769 and R1 244 231 respectively, on 1 March 20.24.

1. Convertible debenture is a compound instrument with Liability and Equity component on 1 March 20.24. (T)
2. The tax base of the liability component on 1 March 20.24 is equal to the initial carrying amount of the liability and equity i.e. R19 000 000 (proceeds of R20 000 000 less transaction costs of R1 000 000) and the carrying amount of the liability is R17 755 769 (IAS 12.23) . (2)
3. A taxable temporary difference arises from the initial recognition of the equity component of R1 244 231, separately from the liability component. Therefore, the initial recognition exception in terms of IAS 12.15(b) is not applicable (IAS 12.23). (2)
4. Consequently, Gasolina recognises a deferred tax liability. (1)
5. In terms of IAS12.61A(b) (or IAS 12.23), deferred tax is recognised (charged) directly in equity as it relates to the carrying amount of the equity component of the compound instrument. Therefore, the amount recognised in equity will be R908 289 (R1 244 231 x 73%). (2)
6. On 28 February 20.25, changes in the carrying amount of the liability component consists of interest expense charged and payment made to debenture holders. (1)

CA Liability (1 March 20.24)	R17 755 769	
Coupon payment	(R 2 800 000)	
Interest expense	<u>R 3 116 479</u>	(1)
CA 28 February 20.25	R18 072 248	

7. The taxable temporary difference at year end of R927 752 (CA R18 072 248 - TB R19 000 000), is made up of the changes in carrying amount of the liability. The deferred tax liability arising from the taxable temporary differences of R250 493 (R927 752 x 27%) is recognised in profit or loss as a deferred tax expense (IAS 12.23). (2)

Total	<u>(11)</u>
Maximum	<u>(9)</u>
Y1: Critical thinking	<u>(1)</u>

X1(b): Communication skills – Communicate using clear and concise messaging, in a professional manner, appropriate to the audience and situation

c) Discuss how the share appreciation rights (SARs) issued by Gasolina (Pty) Ltd should be measured for the year ended 28 February 20.25. (Refer to Matter 2.)

- Gasolina, issued/granted share appreciation rights (SARs), linked to the company's share price, to 10 directors to be paid in cash. Therefore, the SARs meet the requirements of a share-based payment arrangement (IFRS 2 Appendix A). (1)
- Gasolina receives services from the directors and in exchange has an obligation to settle the agreement in cash at the end of the vesting period, the transaction is classified as a cash-settled share-based payments (IFRS 2.7). (1)

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability (IFRS 2.30). (T)

- Gasolina shall recognise the services received from the directors and a liability to pay for those services, as the employee render services over the 3-year vesting period (IFRS2.32). (1)
- The liability shall be initially measured at fair value of the share appreciation rights at grant date 1 March 20.24 of R2 925 000 ($R65 \times 5000 \times 9$) (IFRS2.33). (2)
- Until the liability is settled, Gasolina shall remeasure the liability at the end of each reporting period ($(R72 - R65) \times 5000 \times 9$) R315 000 (IFRS2.30). (1)

Available (6)

Maximum (5)

X1: Communication skills (1)

X1(b): Communication skills – Communicate using clear and concise messaging, in a professional manner, appropriate to the audience and situation

(d) Present the statement of changes in equity of Gasolina (Pty) Ltd for the year ended 28 February 20.25, incorporating Matter 3 and the additional information only.

GASOLINA (PTY) LTD

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 28 FEBRUARY 20.25

	Share Capital	Retained Earnings	Reserves	Total (not required)	
	R	R	R	R	
Balance on 1 March 20.24	8 000 000	32 600 000	4 000 000	44 600 000	(1½)
Prior period error [C2]	-	(28 032)	52 560	24 528	(6½)
Restated balance on 1 March 20.24	8 000 000	32 571 968	4 052 560	44 624 528	
Dividends distribution to Shareholders		(3 500 000)		(3 500 000)	(½)
Comprehensive income:					
Profit [C3]		9 518 756		9 518 756	(2½)
Other comprehensive income					
Foreign gain [C4]			186 150	186 150	(2)
Fair value gain [C5]			117 530	117 530	(1)
Balance on 28 February 20.25	4 500 000	42 090 724	4 356 240	50 946 964	
				Total	<u>(14)</u>
				Maximum	<u>(12)</u>
				<i>X1: Communication skills – presentation</i>	<u>(1)</u>

C2. Prior period error	R	
Interest income recognised (100 000 x 8% x 21)	168 000	[1]
Interest income (100 000 x 8% x 16,20)	129 600	[1]
	<u>38 400</u>	
Decrease in Retained earnings (38 400*0.73)	(28 032)	[½]
Foreign gain/loss OCI recognised		
Financial Asset OCI (1/3/20.23) (100 000 x 18,50)	1 850 000	[½]
FA OCI Interest/coupon (100 000 x 7% x16,20) - (100 000 x 8% x 21)	54 600	[1]
	<u>1 904 600</u>	
CA (1 904 600 - {100 000 x 21})	195 400	[½]
Foreign gain/loss OCI		
Financial Asset OCI (1/3/20.23) (100 000 x 18,50)	1 850 000	[½]
FA OCI Interest/coupon (100 000 x 7% x 21) - (100 000 x 8% x 16,2)	(17 400)	[1]
	<u>1 832 600</u>	
CA (1 832 600 – {100 000 x 21})	267 400	[½]
Increase in Reserves (195 400 – 267 400 = 72 000*0.73)	52 560	<u>[6½]</u>
C3. Profit for the year	R	
Profit before income taxes	12 883 52	[½]
Adjust for:		
Interest income on listed bond (100 000 x 8% x 19,5)	156 000	[1]
Adjusted profit before income taxes	13 039 521	
Tax at 27% (R3 478 645 + {R156 000 x 27%})	(3 520 765)	[1]
Profit for the year	<u>9 518 756</u>	<u>[2½]</u>
C4. Foreign gain OCI	R	
FA OCI (1/3/2.024) (125 000 x 21)	(2 625 000)	[½]
Coupon/interest (100 000 x 7% x 23) - (100 000 x 8% x 19,5)	5 000	[1]
Translated Fair value of FA OCI (125 000 x 23)	2 875 000	[½]
Gain (255 000*0.73)	<u>186 150</u>	<u>[2]</u>
C5. Fair value OCI	R	
FA OCI (28/02/20.25)	(2 875 000)	[½]
Translated Fair Value (132 000 x 23)	3 036 000	[½]
Gain (161 000*0.73)	<u>117 530</u>	<u>[1]</u>

QUESTION 2**25 marks****ALL AMOUNTS EXCLUDE VALUE ADDED TAX (VAT) UNLESS OTHERWISE INDICATED.**

You are a student studying towards your Certificate in the Theory of Accountancy (CTA) qualification. As part of your preparation for your final financial accounting examination, you assisted an audit firm with the following client queries:

Jota Ltd (Jota)

Jota conducts business in the retail industry. You are responsible for the preparation of the financial statements of Jota for the year ended 31 December 20.20.

The following information is available for the 20.20 financial year.

DRAFT SUMMARISED TRIAL BALANCE AS AT 31 DECEMBER 20.20

	Notes	Dr R	Cr R
Office buildings at carrying amount	1	2 442 000	
Plant and machinery at carrying amount	1	945 000	
Inventory		831 500	
Cash and cash equivalents		2 044 000	
Prepaid insurance premium	2	88 900	
Trade and other receivables	3	2 405 600	
Deferred tax liability (1 January 20.20)	4		29 400
Share capital			350 000
Retained income			5 805 100
Profit before tax	5		882 500
Trade payables			1 690 000
		<u>8 757 000</u>	<u>8 757 000</u>

Notes**1. Property, plant and machinery**

Property, plant and machinery are accounted for according to the cost model in terms of IAS 16 *Property, Plant and Equipment*.

On 1 January 20.20 Jota purchased land for the future development of a new plant. Due to the worldwide economic crisis and a decline in the property market during the second half of 20.20, the directors agreed to sell the land as soon as possible. The land was sold on 31 October 20.20 at a loss of R200 000 (which is a capital loss for tax purposes – also refer note 4). The purchase and sale transactions on land were correctly recorded in the accounting records of Jota.

Jota depreciates the office buildings at R165 500 per annum, while the South Africa Revenue Service (SARS) permits no deduction on the buildings.

The tax base of the plant and machinery on 31 December 20.20 was R546 000.

2. Insurance contract

The annual insurance premium of R88 900 for the year ending 31 December 20.21 was paid in advance during the current financial year. There were no prepaid expenses for the financial year ending 31 December 20.19.

3. Trade and other receivables

Trade and other receivables consisted of the following on 31 December 20.20:

	Dr/(Cr) R
Trade receivables	2 595 300
Allowance account for credit losses	(410 600)
Other receivables	220 900
Balance at year end	<u>2 405 600</u>

SARS allowed Jota to claim a doubtful debt allowance of R102 650 in terms of section 11(j) of the Income Tax Act.

4. Deferred tax liability

The net deferred tax liability of R29 400 at 31 December 20.19 was correctly calculated and consists of the following:

	Dr/(Cr) R
Property, plant and equipment	(143 661)
Allowance account for credit losses	67 221
Unused tax loss	47 040
Net deferred tax liability	<u>(29 400)</u>

All the temporary differences that gave rise to the net deferred tax liability of R29 400 were taxed at 27%. The final tax assessment issued by SARS for the financial year ended 31 December 20.19 reflected an assessed tax loss of R174 222 which was accepted by Jota.

On 31 December 20.19 the management of Jota was of the opinion that future taxable profits and future capital gains were probable as the budget for the coming financial year showed a sharp increase in profits as a result of a new contract obtained by Jota. This opinion of management remained unchanged for the financial year ended 31 December 20.20.

The current tax expense for the year ended 31 December 20.20 was correctly calculated at R657 434 (after taking into account all the information provided in these notes). Deferred tax for the year ended 31 December 20.20 has not yet been calculated or provided for.

5. Profit before income taxes

You may assume that all transactions, except for the accounting error in note 6, were correctly accounted for in profit before income taxes.

The following items are included in profit before income taxes:

5.1 Dividend income

Dividend income received from a local resident company to the amount of R140 000.

5.2 Fines

On 28 July 20.20 the Competition Commission fined Jota for retail price fixing. The Competition Commission imposed a penalty of R1 398 500 on Jota because of the existence of a vertical agreement between Jota and Origi Ltd for setting retail prices. The fine was immediately payable.

6. Accounting error

On 30 November 20.19 Jota received an amount of R575 000 (VAT inclusive) from a customer for services that were only rendered during March 20.20. The accountant recognised the R575 000 as revenue in November 20.19 and did not allocate the VAT of 15% to the VAT output account. As a result the R575 000 was included in revenue for the financial year ended 31 December 20.19. For tax purposes, the R575 000 was taxed in the financial year ended 31 December 20.19. SARS indicated that they will re-open the 20.19 assessment to correct the amount of VAT that was incorrectly included in taxable profit. The figures in the trial balance have not yet been adjusted to account for the correction of the accounting error (the error is regarded as material).

Additional information

- The normal tax rate is 27%. The capital gains tax inclusion rate is 80% for the years ended 31 December 20.19 and 31 December 20.20.
- The VAT rate is 15% for all periods.
- Jota is a registered VAT vendor.

REQUIRED

YOU HAVE 50 MINUTES TO ANSWER THIS QUESTION

	Marks
(a) Prepare the following note to the financial statements of Jota Ltd for the financial year ended 31 December 20.20: - Income tax expense in terms of IAS 12.79-12.80 and 12.81(c)(i). Please note: - Comparative figures are not required. - The movement in temporary differences in the current tax calculation must be calculated using the statement of financial position method.	16
(b) Discuss the effect that the correction of the R575 000 with regard to services rendered (which was incorrectly recognised as revenue in the 31 December 20.19 financial year) will have on all the line items in the statement of profit or loss and other comprehensive income of Jota Ltd for the year ending 31 December 20.20. <i>X1: Communication skills: logical argument</i> Please note: - Your discussion should include amounts where relevant. Please note: - Round off all calculated amounts to the nearest Rand. - Your answer must comply with IFRS Accounting Standards.	8
	1

QUESTION 2 – Suggested solution

- (a) Prepare the following note to the financial statements of Jota Ltd for the financial year ended 31 December 20.20:
- Income tax expense in terms of IAS 12.79-12.80 and 12.81(c)(i).

JOTA LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.20

3. Income tax expense

Major components of tax expense

	20.20	
	R	
SA normal tax		
Current tax		
Current year (given)	657 434	(1)
Deferred tax	110 986	
Movement in temporary differences (taxable) [C1]	107 146	(7)
Unused tax loss utilised [C1]	47 040	(1)
Unused capital loss created [C1]	(43 200)	(1)
	<u>768 420</u>	
Tax rate reconciliation		
Accounting profit $(882\,500 + (575\,000 \times 100/115))$	<u>1 382 500</u>	(1)
Tax at 27%	373 275	(1)
Tax effect of non-taxable /non-deductible items		
Dividends not taxable $(140\,000 \times 27\%)$	(37 800)	(1)
Capital loss on sale of land not deductible $(200\,000 \times 20\% \times 27\%)$	10 800	(1)
Depreciation on office buildings not deductible $(165\,500 \times 27\%)$	44 550	(1)
Penalties not deductible $(1\,398\,500 \times 27\%)$	377 595	(1)
	<u>768 420</u>	
	Total	<u>(16)</u>

CALCULATIONS

C1. Deferred tax

	Carrying amount	Tax base	Temporary difference at 100% or 80%	Deferred tax at 27% asset/ (liability)	
	R	R	R	R	(1/2)
31 December 20.19					
Property plant and equipment (given)	?	?	¹ 532 078	(143 661)	(1)
Allowance for credit losses (given)	?	?	² (248 967)	67 221	(1)
Revenue received in advance (error)	500 000)	-	(500 000)	135 000	(1)
Unused tax loss (given)		174 222	(216 889)	58 560	(1)
Net deferred tax asset			(174 222)	47 040	(1)
			(391 111)	105 600	
¹ 143 661/27% = 532 078					
² 67 221/27% = 248 967					
³ 575 000 x 100/115 = 500 000					
31 December 20.20					
Office building	2 442 000	-	Exempt	-	(1)
Property plant and equipment	945 000	546 000	399 000	(107 730)	(1)
Allowance for credit losses (given)	(410 600)	¹ (102 650)	(307 950)	83 147	(1½)
Prepaid insurance premium	88 900	-	88 900	(24 003)	(1)
Unused capital loss	-	200 000	179 950	(48 586)	(1)
			² (160 000)	43 200	
			19 950	(5 386)	

¹ 410 600 x 25% = 102 650 or 410 600 – (410 600 x 75%) = 102 650

² 200 000 x 80% = 160 000

Movement in temporary differences (excluding unused)
tax loss and unused capital loss) (taxable)

(179 950 - (216 889)) 396 839 (107 146)

Movement in unused tax loss (reversal of deductible) 174 222 (47 040)

Movement in unused capital loss (deductible) (160 000) 43 200

Total movement in temporary differences 411 061 (110 986)

- (b) Discuss the effect that the correction of the R575 000 with regard to services rendered (which was incorrectly recognised as revenue in the 31 December 20.19 financial year) will have on all the line items in the statement of profit or loss and other comprehensive income of Jota Ltd for the year ending 31 December 20.20.

The R575 000 which have been incorrectly recognised as revenue in the 31 December 20.19 financial year constitute a **prior period material error** in terms of IAS 8 *Basis of preparation of financial statements* and has to be **corrected retrospectively**. (1)

An entity shall correct material prior period errors **retrospectively** in the **first set of financial statements** authorised for issue after their discovery by restating the comparative amounts for the prior period(s) presented in which the error occurred (IAS 8.42 (a)). (1)

A prior period error shall be corrected by retrospective restatement as the period-specific effect is **not impracticable to determine (the applicable financial year is 20.19)** (IAS 8.43). (1)

Jota must, therefore, correct the error in the financial statements for the year ended 31 December 20.20 by restating the 20.19 comparative figures. (1)

The following line items of the statement of profit or loss and other comprehensive income have been affected by the error and must be restated as follows:

- The **20.19 comparative figures for revenue** must be **decreased** with **R575 000** since it should be reflected as revenue received in advance for the year ended 31 December 20.19. Revenue amounting to **R500 000** (excluding VAT) must only be recognised in March 20.20. Therefore, the **revenue** for the year ended **31 December 20.20 need to be increased with R500 000**. (2)
- The **20.19 comparative figures for the income tax expense (current tax)** has to be **decreased** with **R20 250** ($R75\ 000 \times 27\%$), to correct the VAT that was incorrectly included in the 20.19 comparative figures for revenue, since the SARS agreed to reopen the prior year assessment. (2)
- The **20.19 comparative figures for income tax expense (deferred tax)** has to be **decreased** with **R135 000** ($500\ 000 \times 27\%$), to provide for the deferred tax asset relating to the revenue received in advance. (1)

Total (9)

Maximum (8)

X1: Communication skills: logical argument (1)

QUESTION 3**27 marks****IGNORE ANY VAT IMPLICATIONS**

You are an IFRS expert who is employed by Jsauhm Consultants. The following independent and unrelated issues were brought to your attention for your expert advice and opinion.

Client 1: Lallana Ltd (Lallana)**18 marks**

Lallana is a company operating in the manufacturing and maintenance industry. Lallana is listed on the Johannesburg Stock Exchange and has a 31 December financial year end.

You are currently reviewing the financial statements of Lallana. Your assistant has presented the following schedule of information relating to the year ended 31 December 20.24:

Item	R
Lallana's accounting profit for the year ended 31 December 20.24 after correctly accounted for all items:	5 750 000
Dividends received: Dividends received are exempt from normal tax in terms of s 10(1)(k).	74 500
Foreign income received (after deduction of R5 000 relating to foreign taxes): The foreign income is not taxable in South Africa.	35 000
Gain on disposal of land: Lallana purchased land for the future development of a new factory building on 31 March 20.23. Due to the recent availability of factory buildings in the area, Lallana sold the land at an amount of R1 550 000 on 1 January 20.24. The original cost of the land amounted to R1 200 000. Land is measured according to the cost model in terms of IAS 16 <i>Property, Plant and Equipment</i> . The proceeds from the sale of land is a receipt of a capital nature for tax purposes.	350 000
Depreciation on plant and equipment: The tax allowances on the plant and equipment amounted to R900 000. On 31 December 20.24 the carrying amount of the plant and equipment amounted to R3 168 000 while the tax base was R2 500 000.	876 000
Correction of prior period error: On 30 November 20.23 Lallana received an amount of R300 000 from a customer for services that were rendered during February 20.24. The accountant recognised the R300 000 as revenue in November 20.23. For tax purposes, the R300 000 was taxed in the financial year ended 31 December 20.23.	300 000
Assessed tax loss on 31 December 20.24: Lallana suffered operating losses during the previous financial year and had an assessed tax loss of R900 000 on 31 December 20.23. The company correctly utilised R344 000 of the assessed tax loss by recognising a deferred tax asset of R92 880 relating to the assessed loss on 31 December 20.23.	-

Additional information

- There are no temporary differences other than those that are apparent from the information contained in the question.
- The only non-taxable and non-deductible items included in the accounting profit or loss are those that are apparent from the information provided.
- The normal income tax rate is 27% and the capital gains tax inclusion rate is 80%.
- You may assume that all amounts are material.

Client 2: Maiweather Ltd (Maiweather)**9 marks**

The financial manager, Mr Matlala, prepared the statement of financial position of Maiweather as at 31 December 20.24 and sent you a copy for a final review. You have assisted Mr Matlala with the previous year's financial statements and he awaits your feedback to finalise the financial statements for the year ended 31 December 20.24 before he sends it to the chief financial officer for approval. Mr Matlala provided you with notes regarding the matters that he is unsure of.

MAIWEATHER LTD**STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.24**

	Notes	20.24 R'000
ASSETS		
Non-current assets		
Property, plant and equipment		39 500
Intangible assets		6 700
		<u>46 200</u>
Current assets		
Inventories		20 200
Trade receivables	1	20 500
Other current assets		1 500
Cash and cash equivalents		2 500
		<u>44 700</u>
Total assets		<u><u>90 900</u></u>
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital		14 200
Retained earnings		31 000
Other components of equity		1 500
Total equity		<u>46 700</u>
Non-current liabilities		
Long-term borrowings	2	24 600
Total non-current liabilities		<u>24 600</u>
Current liabilities		
Trade and other liabilities		3 300
Allowance for credit losses	1	1 500
Short-term borrowings	3	2 500
Current tax payable		9 500
Deferred tax		2 800
Total current liabilities		<u>19 600</u>
Total liabilities		<u>44 200</u>
Total equity and liabilities		<u><u>90 900</u></u>

Notes

1. Maiweather uses the simplified approach in accordance with IFRS 9 *Financial Instruments* when determining the expected credit losses for trade receivables. The R1 500 000 allowance for credit losses is the lifetime expected credit losses of the trade receivables.
2. Long-term borrowings of R24 600 000 represents a loan obtained from Africa Bank. The interest rate charged by Africa Bank is market related. The loan is repayable over 10 years. The loan instalments of R4 500 000 each are payable on 31 December of each year. The instalment on 31 December 20.25 will consist of R1 860 000 interest and a R2 640 000 capital re-payment.
3. On 1 April 20.24 Maiweather obtained a short-term loan from Smart Bank amounting to R2 500 000. The loan and interest is repayable on 31 March 20.25, however the terms of the agreement stipulates that Maiweather has the discretion to extend the loan's repayment date to 31 December 20.26 at an additional fee of R50 000. The applicable interest rate for the extended period will be renegotiated. Mr Matlala indicated that the chief financial officer has instructed him to start with the negotiation of the new interest rate for the extended loan period with Smart Bank since Maiweather intends to extend the loan.

REQUIRED

YOU HAVE 26 MINUTES TO ANSWER THIS QUESTION

	Marks
(a) Prepare the income tax note to the financial statements of Lallana Ltd for the year ended 31 December 20.24 as required by IAS 12.79, 80 and 81(c)(i) <i>Income Taxes</i> (refer to client 1). Please note: • Comparative figures are not required. • The movement in temporary differences in the current tax calculation has to be calculated by using the statement of financial position method. <i>X1: Communication skills: presentation and layout</i>	17
Please note: • Round off all amounts to the nearest Rand. • Your answer must comply with IFRS Accounting Standards.	1

QUESTION 3 – Suggested solution

- (a) Prepare the income tax note to the financial statements of Lallana Ltd for the year ended 31 December 20.24 as required by IAS 12.79, 80 and 81(c)(i) *Income Taxes* (refer to client 1).

LALLANA LTD

NOTES FOR THE YEAR ENDED 31 DECEMBER 20.24

11. Income tax expense

Major components of tax expenses

	20.24	
	R	
SA normal taxation	1 172 205	(5)
Foreign tax	5 000	(1)
Current tax expense	1 177 205	
Deferred tax – movement in temporary differences	180 360	(6)
	<u>1 357 565</u>	
Tax rate reconciliation		
Accounting profit	5 750 000	(½)
Taxation at 27%	1 552 500	(½)
Tax effect of non-deductible/non-taxable items:		
- Dividends received (74 500 x 27%)	(20 115)	(1)
- Accounting profit on land not taxable (350 000 x 20% x 27%)	(18 600)	(1)
Difference in tax rate on foreign income (5 000 - (40 000 x 27%))	(5 800)	(1)
Unused tax loss that was not previously recognised	(150 120)	(1)
	<u>1 357 565</u>	
	Total	<u>(17)</u>
		<u>(1)</u>

X1: Communication skills: presentation and layout

CALCULATIONS

C1. Deferred tax

	Carrying amount	Tax base	Temporary difference at 100% or 80%	Deferred tax 27% asset/ (liability)	
31 December 20.23					
Land	1 200 000	1 200 000	-	-	
Plant (3168 + 876) (2500 + 900)	4 044 000	3 400 000	644 000	(173 880)	
Contract liability	(300 000)	-	(300 000)	81 000	
			344 000	(92 880)	
Unused tax loss		900 000	(344 000)	92 880	
			-	-	
31 December 20.24					
Land	-	-	-	-	
Plant	3 168 000	2 500 000	668 000	(180 360)	[2]
			668 000	(180 360)	
Unused tax loss	-	-	-	-	
			668 000	(180 360)	
Movement in temporary differences through P/L (668 000 - 344 000)			324 000	(87 480)	[3]
Movement in unused tax loss			344 000	(92 880)	[1]
			668 000	(180 360)	

C2. Current tax calculation

Profit	5 750 000	
Non-taxable/Non-deductible items:		
- Dividends received not taxable	(74 500)	[½]
- Accounting profit on land not taxable (350 000 x 20%)	(70 000)	[1]
- Foreign income (35 000 + 5 000)	(40 000)	[1]
Movement in temporary differences	(324 000)	[1]
Taxable profit before income taxes loss	5 241 500	
Unused loss of prior year	(900 000)	[1]
	4 341 500	
Tax at 27%	1 172 205	[½]
		[5]



DISCUSSION

Did you notice the difference in the treatment of the error when determining the profit for this question compared to the previous question? In question 2, it was stated that the profit before income taxes was correctly calculated, before taking the accounting error into account, therefore the accounting error will need to be considered when calculating the profit.

In this question, Lallana's accounting profit for the year ended 31 December 20.24 is provided with the statement that the profit amount is provided after correctly accounting for all items. Therefore, it is not required to adjust the profit with the error.

QUESTION 4**35 marks**

Leo Ltd (Leo) specialises in the manufacturing and selling of sports clothing products and is listed on the Johannesburg Stock Exchange. Leo Ltd is a wholly owned subsidiary of Panther Ltd (Panther) since its incorporation. You are a recently qualified chartered accountant and recently started working at Leo Ltd as a financial accountant. You are preparing the financial statements for the financial year end 31 December 20.20 and have been provided with the following information:

1. Preference shares

Leo issued 800 000 compulsory convertible preference shares at an issue price of R10 per preference share on 1 July 20.20. The convertible preference share has a face value of R11 each. Dividends are payable annually on 30 June at 12%. These preference shares are compulsory convertible on 30 June 20.25 at one ordinary share for each preference share held. A market-related interest rate on 1 July 20.20 for preference shares issued without conversion rights was 10% per annum.

Panther purchased the 800 000 preference shares when they were issued and does not hold them for trading purposes. The fair value of one convertible preference shares was R12 on 31 December 20.20.

2. Share-appreciation rights

On 1 January 20.19 Leo entered into an agreement with the directors of Panther. According to the agreement all 12 directors of Panther will each receive 4 500 share appreciation rights (SARs). This is part of Panther's remuneration policy for subsidiaries to reward its executive directors. The SARs will vest on 31 December 20.21, provided that the directors remain in service of Panther.

Each SAR entitles the director to a cash amount equal to Leo's share price on the exercise date. Vested SARs may be exercised on or before the earlier of 31 December 20.23 or the date on which an employee resigns. If they are not exercised by this date, the rights will lapse.

The fair value of SARs was determined using an option pricing model. The following information in respect of the SARs scheme is provided:

Date	Actual number of employees still employed at relevant date	Estimated number of employees expected to be employed at vesting dates	Fair value per SAR	Leo share price
			R	R
1 January 20.19	12	11	7,80	35
31 December 20.19	12	11	8,20	38
31 December 20.20	11	10	9,50	39
31 December 20.21	?	10	10,20	41

3. Bond at fair value

Leo purchased a foreign bond on 1 January 20.20 for its fair value (which also equalled the face value at this date). Leo correctly classified this bond at fair value through other comprehensive income. The bond has five years to maturity and carries an arrear annual coupon rate of 8% payable on 31 December each year. The bond coupon rate is equivalent to its effective interest rate, as there are no transaction costs nor premium or discount on redemption of the bond relative to the face value.

The credit risk since initial recognition of the bond is determined as follows:

- 1 January 20.20 – low credit risk, and
- 31 December 20.20 – no change since initial recognition

Details relating to the bond:

Date	Bond			
	Spot rate \$1=	Fair value \$	Total expected credit losses	
			12 Month \$	Lifetime \$
1 January 20.20	R12,50	120 000	1 800	2 500
31 December 20.20	R13,75	128 000	1 800	2 750
Average rate 20.20	R11,12			

At no stage was the bond considered to be credit impaired and the interest payments were received on time.

Assume that the South African Revenue Services (SARS) will not allow expected credit losses on the bonds as a deduction for income tax purposes and that the SARS accepts the amortised cost of the bonds as the tax base of the bonds. Only when the credit risk realises will the SARS allow such losses as actually incurred.

The SARS indicated that any future taxable profits will be taxed at 27%.

QUESTION 4

YOU HAVE 70 MINUTES TO ANSWER THIS QUESTION

REQUIRED

	Marks
(a) Discuss how Panther Ltd should classify the compulsory convertible preference shares. <i>X1: Communication skills: clarity of expression</i>	7 1
(b) Prepare an extract of the statement of financial position of Leo Ltd as at 31 December 20.20, showing how the convertible preference shares and share appreciation rights will be presented. Please note: • Comparatives are not required. • Ignore all tax implications. <i>X1: Communication skills: presentation and layout</i>	9 1
(c) Provide the journal entries to account for the bond for the year ended 31 December 20.20 in the accounting records of Leo Ltd. Please note: • Journal narrations are not required. • Journals should be dated. • Ignore all tax implications.	13
(d) Discuss the tax implications of the bond transaction. Calculations are not required. Please note: • Round off all amounts to the nearest rand. • Your answer must comply with IFRS Accounting Standards.	4

QUESTION 4 – Suggested solution

(a) Discuss how Panther Ltd should classify the compulsory convertible preference shares.

Panther purchased the convertible preference shares and should recognise a financial asset and determine classification in terms of IFRS 9. (1)

To classify the preference shares, consideration of the nature of the contractual cash flows should be made: (1)

- Panther has a contractual right to receive dividends annually in the form of interest income. (1)
- There is no capital repayment, since the preference shares are compulsory convertible into shares. Panther has the right to receive ordinary shares. (1)
- The contractual cash flows do not represent payments solely of interest and capital. Therefore, the amortised cost classification to measure debt instruments cannot be applied. (1)

Panther should then consider classification at fair value through profit or loss or the option to elect fair value through other comprehensive income in terms of IFRS 9.5.7.5. (1)

However, the IFRS 9.5.7.5. cannot be elected by Panther, since the preference shares are not pure equity instruments, as there is a contractual right for Panther to receive interest payment. (1)

Therefore, Panther should classify the preference shares as measured at fair value through profit or loss (1)

Total (9)

Maximum (7)

X1: Communication skills: clarity of expression (1)

(b) Prepare an extract of the statement of financial position of Leo Ltd as at 31 December 20.20, showing how the convertible preference shares and share appreciation rights will be presented.

LEO LTD

EXTRACT OF STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.20

	R	
Equity and liabilities		
Equity component of convertible preference shares (C1)	3 996 929	(3)
Non-current liabilities		
Financial liability (4 203 225 (C1.2) – 1 056 000)	3 147 225	(3)
Cash settled share-based payment (4 500 x 10 x 9,50 x 2/3)	285 000	(2)
Current liabilities		
Financial liability – short term portion (C1.2)	1 056 000	(1)
	Total	(9)
		(1)

X1: Communication skills: clarity of expression (1)



DISCUSSION

The dividend payment on the preference shares is due on 30 June 20.21. Therefore, the dividend payment of R1 056 000 should be deducted from non-current liabilities and added to the short-term portion. The interest accrued to the liability of R200 154 [C1] is not short-term and should be added to the non-current liability

Cash settled share-based payments: the vesting period is from 1 January 20.19 to 31 December 20.21 (3 years). At 31 December 20.20 only 2 years have passed and therefore the share-based payment liability will need to be apportioned for 2/3.

CALCULATIONS

C1. Convertible preference shares

C1.1 Fair value of financial liability component

N	=	5	[½]
I	=	10%	[½]
PMT	=	1 056 000 (800 000 x R11 x 12%)	[½]
FV	=	0	[½]
PV	=	4 003 071	

Proceeds (800 000 x R10)	8 000 000	[1]
Present value of financial liability	<u>(4 003 071)</u>	
Equity component (balancing)	<u>3 996 929</u>	<u>[3]</u>

C1.2 Value of liability component

4 003 071 [C1.1] + 1 Amort interest 400 307 x 6/12 = 200 154	<u>4 203 225</u>	[2]
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- (c) Provide the journal entries to account for the bond for the year ended 31 December 20.20 in the accounting records of Leo Ltd.

		Dr R	Cr R	
	1 January 20.20			
J1	Financial asset at fair value through OCI: bond (SFP) (120 000 x 12,5)	1 500 000		(1)
	Bank (SFP)		1 500 000	(1)
	Recognise purchase of bond			
J2	Expected credit losses (P/L) (1 800 x 12,5)	22 500		(1)
	Expected credit loss reserve (OCI)		22 500	(1)
	Recording 12-month expected credit loss			
J3	31 December 20.20			
	Bank (SFP) (120 000 x 8% x 13,75)	132 000		(1)
	Financial asset at fair value through OCI: bond (balancing) (SFP)		25 248	(1)
	Interest income (P/L) (120 000 x 8% x 11,12)		106 752	(1)
	Recognise effective interest income and coupon interest received			
J4	Financial asset at fair value through OCI: bond (SFP) ((1 500 000 (J1) - 25 248 (J3)) – (120 000 x13,75))	175 248		(1)
	Expected credit loss reserve (OCI ((22 500 (J2) - 1 800 x 13,75)		2 250	(1)
	Foreign exchange gain (OCI) (175 248 – 2 250)		172 998	(1)
	Recognition of foreign exchange gain			
J5	Financial asset at fair value through OCI: bond (SFP)	110 000		(2)
	Fair value gain (OCI) ((1 500 000 (J1) – 25 248 (J3) + 175 248 (J4)) – (128 000 x13,75))		110 000	(1)
	Recognition of fair value gain on investment			
			Total	<u>(13)</u>

- (d) Discuss the tax implications of the bond transaction. Calculations are not required.

There is no deferred tax on the amortised cost accounting for the bond, as the carrying amount and tax base will be the same. (1)

Expected credit losses on the bond are not allowed as a deduction for income tax purposes, and only when the credit risk realises will the SARS allow such losses as actually incurred. (1)

The interest income and foreign exchange adjustments will attract current tax at the normal tax rate of 27%. (1)

The Income Tax Act does not allow a tax deduction for fair value adjustments and, therefore, there will be deferred tax consequences on the fair value adjustments recognised in other comprehensive income. (1)

As the bond is held to collect contractual cash flows and for sale (requirement to account for at fair value through OCI), it is likely that the applicable tax rate on sale of the bond is the normal tax rate of 27%. Therefore, the CGT rate will not be applicable. (1)

Total (5)
Maximum (4)

QUESTION 5

PART I

28 marks

IGNORE ANY NORMAL INCOME TAX IMPLICATIONS

Satoshi Ltd (Satoshi) is a South African company listed on the Johannesburg Stock Exchange and has a 31 December year end. Satoshi sells rock drilling machines which are used in quarries and open pit mines throughout South Africa.

After a successful exhibition at the Electra Mining Africa show during 20.24, Satoshi received various queries from companies operating in Botswana relating to the rock drilling machines. Satoshi imports machines that can withstand extreme temperatures from South Korea.

The profit before income taxes for the year ended 31 December 20.24 is R32 560 000 before processing the necessary journals to account for the transactions below. The balance of share capital and retained earnings at 1 January 20.27 is R243 678 000 and R56 780 000, respectively.

1. Rock drilling machines imported

To ensure that Satoshi will be able to meet the increased demand for the rock drilling machines that can withstand extreme temperatures, Satoshi decided on 1 September 20.24 to import three rock drilling machines at a cost of KRW 204 000 000 each. The official currency of South Korea is the South Korean Won (KRW). The machines were delivered to Satoshi on 1 October 20.24. Control of the machines passed to Satoshi on delivery date.

The foreign creditor was payable as follows:

	KRW
1 December 20.24	408 000 000
1 February 20.25	204 000 000
	<u>612 000 000</u>

The above repayment terms are normal credit terms.

On 1 October 20.24 Satoshi entered into a five-month forward exchange contract (FEC) for the KRW 204 000 000, payable on 1 February 20.25, to hedge itself against foreign currency risk at a forward rate of KRW 1 = R0,01. Satoshi does not apply hedge accounting in terms of IFRS 9 *Financial Instruments*.

The applicable exchange rates were as follows:

	Spot rate R1 = KRW	Forward rate R1 = KRW
1 September 20.24	110	
1 October 20.24	102	
1 December 20.24	95	90 (2 months)
31 December 20.24	90	85 (1 month)
1 February 20.25	98	

One of the machines was sold to a new Botswana client on 1 December 20.24 for R2 500 000 and the other two machines were sold in March 20.25.

2. Disposal of investment

Satoshi holds an investment in Nakamoti Ltd bonds with an amortised cost of R5 600 000 on 31 December 20.23. These bonds were held within a portfolio of investments that Satoshi manages in order to collect contractual cash flows of interest and principal. The bonds have an effective interest rate of 10% per annum, interest is payable annually and the bonds are redeemable at par value on 31 December 20.29. On 1 July 20.24, Satoshi decided to sell the bonds for R5 950 000 to finance capital expenditure. The bonds were never credit impaired and no credit losses were expected throughout the life of the financial asset.

3. Share-based payment arrangement

On 1 January 20.23 Satoshi entered into an arrangement with a key senior employee. The terms of the arrangement are as follows:

- Satoshi grants the employee the right to receive either a cash payment equal to the value of 800 shares or 900 actual shares.
- Satoshi has the choice of settlement.
- The grant is conditional on the completion of two years' service.
- If shares are issued, they should be held for two years after vesting date.

Satoshi does not have a present obligation to settle in cash. It was expected that the senior employee will remain with the company until 31 December 20.24. The fair value of one Satoshi share was as follows on the respective dates:

Date	Fair value	Fair value with a two-year post-vesting transfer restriction
	R	R
1 January 20.23	198	190
31 December 20.23	211	200
31 December 20.24	220	210

On 31 December 20.24 Satoshi decided to elect the choice of settlement with the lower fair value as at 31 December 20.24.

4. Investment in debt instrument

On 1 January 20.24 Satoshi acquired an investment in Redid Ltd bonds at a fair value of R3 000 000. No transaction costs were paid. The bonds pay coupon interest of R400 000 on 31 December of each year and will be redeemed on 31 December 20.26 at a face value of R2 500 000. Satoshi holds these bonds to collect the contractual cash flows and, when an opportunity arises, it will sell the bonds to re-invest the cash in other financial assets at a higher return. Therefore, both collecting contractual cash flows and selling the bonds are integral in achieving the business model's objective. On 1 January 20.24 the bonds were not credit impaired and no credit losses were expected. However, on 31 December 20.24 the credit risk had increased significantly since initial recognition, but the bonds were not credit impaired. The fair value of the bonds on 31 December 20.24 is R2 500 000.

The financial manager of Satoshi provided you with the following schedule of the assessed credit risk and estimated expected credit losses of its investment in the Redid Ltd bonds:

Date	Assessed credit risk	12-month expected credit losses R	Lifetime expected credit losses R
31 December 20.24	High (not credit impaired)	32 000	500 000

PART II**12 marks**

GreenBottles Ltd is a manufacturer of water bottles and jugs that are made with economic-friendly fibre. The company was incorporated in 20.18 and has a 31 December year end. You are the newly appointed financial manager of GreenBottles Ltd. The financial director sent you an extract of the statement of financial position, the accounting policies and notes relating to the financial assets of GreenBottles Ltd.

GreenBottles Ltd**Extract from the statement of financial position as at 31 December 20.24**

	Notes	20.24 R
Non-current assets		
Financial assets measured at fair value through OCI	4	500 000
Financial assets measured at amortised cost	5	600 000
Current assets		
Trade and other receivables	6	380 000

Extract from the notes for the year ended 31 December 20.24**1. Accounting policies****1.1 Trade receivables**

Trade receivables consist of the day-to-day trade receivables only, and do not contain a significant financing component.

1.2 Allowance for credit losses for trade receivables

The allowance for credit losses is assessed each year based on the following:

- If the credit risk has not increased significantly, 12-month expected credit losses are used.
- If the credit risk increased significantly, the loss allowance will be equal to the lifetime expected credit losses.
- Interest is calculated using the effective interest rate method.

4. Financial assets at fair value through other comprehensive income

These investments consist of shares in two companies listed on the Johannesburg Stock Exchange (JSE). At initial recognition, the entity irrevocably elected to measure these equity instruments at fair value through other comprehensive income in terms of IFRS 9.4.1.4. Both companies declared dividends during the financial year.

5. Financial assets measured at amortised cost

The investments in financial instruments comprise the following:

Type of instrument	R
1 000 Bonds in Morning Ltd	247 000
800 Bonds in Flowers Ltd	190 000
100 Bonds in Rose Ltd	163 000
Total	600 000

The contractual cash flows received from bonds consist solely of payments of principal and interest on the principal amount outstanding. The funding needs of GreenBottles Ltd are predictable and the maturity of the investments in bonds is matched to the estimated funding needs of GreenBottles Ltd. As per the policy of the portfolio, if the bonds fall below the F1 rating in terms of Fitch Ratings, the risk of collecting contractual cash flows will become high. Under such circumstances the bonds will be disposed of. The bonds in Flowers Ltd were disposed of during the year, as their ratings dipped below F1.

6. Trade and other receivables

	R
Trade receivables	400 000
Less: Allowance for credit losses	<u>20 000</u>
Net trade receivables	<u>380 000</u>

Additional information

- All risk related disclosure has correctly been disclosed in a separate note in the financial statements and is correct in terms of IFRS 7 *Financial Instruments: Disclosure*.
- The financial director is of the opinion that the portfolio of investment in bonds (refer to disclosure note 5) should be reclassified from amortised cost to financial assets measured at fair value through other comprehensive income, because the bonds will probably not be held to maturity due to the possible increase in credit risk or unanticipated funding needs of GreenBottles Ltd.

QUESTION 5

YOU HAVE 80 MINUTES TO ANSWER THIS QUESTION

REQUIRED

	Marks
PART I	
(a) Provide the journal entries to account for the investment in Nakamoti Ltd bonds (refer to note 2) in the financial statements of Satoshi Ltd for the year ended 31 December 20.24. Please note: Journal narrations are not required.	5
(b) Calculate the profit before income taxes in the financial statements of Satoshi Ltd for the year ended 31 December 20.24.	13
(c) Present the information provided of Satoshi Ltd in the statement of changes in equity for the year ended 31 December 20.24. <i>X1: Communication skills: presentation and layout</i> Please note: - Total columns are not required. - Comparative amounts are not required but opening balances at 1 January 20.24 are required.	8
PART II	
(a) Discuss in terms of IFRS 9 <i>Financial Instruments</i> whether the portfolio of bonds (refer to disclosure note 5) should be reclassified as financial assets measured at fair value through other comprehensive income.	4
(b) Write an email to the financial director discussing your concerns in terms of IFRS 7 <i>Financial Instruments: Disclosures</i> and IFRS 9 <i>Financial Instruments</i> relating to the following notes provided: - Accounting policies - Financial assets measured at fair value through other comprehensive income - Trade and other receivables <i>X1: Communication skills: layout and conclusion</i>	7
	1

QUESTION 5 – Suggested solution

PART I

- (a) Provide the journal entries to account for the investment in Nakamoti Ltd bonds (refer to note 2) in the financial statements of Satoshi Ltd for the year ended 31 December 20.24.

		Dr R	Cr R	
	1 July 20.24			
J1	Financial asset at amortised cost (SFP)	280 000		(½)
	Interest income (P/L) $(5\,600\,000 \times 10\% \times 6/12)$		280 000	(1½)
J2	Bank (SFP)	5 950 000		(1)
	Financial asset at amortised cost (SFP)			
	$(5\,600\,000 + 280\,000)$		5 880 000	(1)
	Gain on disposal (P/L)		70 000	(1)
				<u>(5)</u>

- (b) Calculate the profit before income taxes in the financial statements of Satoshi Ltd for the year ended 31 December 20.24.

	R	
Profit given	32 560 000	(½)
Investment in bonds sold (from a):		
- Interest income	280 000	(½)
- Gain on disposal	70 000	(½)
Inventory imported:		
Foreign exchange difference (loss): creditor remeasure 1 December (KRW 612 000 000/102 = R6 000 000) – (KRW 612 000 000/95 = R6 442 105)	(442 105)	(2)
Foreign exchange difference (loss): creditor remeasure at closing 31 December (KRW 204 000 000/95 = R2 147 368) – (KRW 204 000 000/90 = R2 266 667)	(119 299)	(2)
Cost of sales (KRW 204 000 000/102)	(2 000 000)	(1)
Sales	2 500 000	(½)
FEC:		
Fair value gain of FEC ((KRW 204 000 000/100 (1/0,01) or (KRW 204 000 000 x 0.01) = R2 040 000) – (KRW 204 000 000/85 = R2 400 000)	360 000	(2)
Share-based payment:		
Employee benefit cost $(900 \times 190 \times \frac{1}{2})$	(85 500)	(1)
Investment in debt instrument:		
- Interest income $(3\,000\,000 \times 8,21\%^1)$	246 298	(2)
¹ Effective interest rate (PV = (3 000 000); PMT = 400 000; FV = 2 500 000; N = 3)		
- Expected credit losses	(500 000)	(1)
Total	<u>32 869 394</u>	<u>(13)</u>

(c) Present the information provided of Satoshi Ltd in the statement of changes in equity for the year ended 31 December 20.24.

Statement of changes in equity of Satoshi Ltd for the year ended 31 December 20.24

	Share capital	Retained earnings	Fair value adjustments on debt instruments	Expected credit losses reserve	Share-based payment reserve	
	R	R	R	R	R	
Balance at 1 January 20.24	243 678 000	56 780 000			¹ 85 500	(2)
Share-based payment (from b)					85 500	(¹ / ₂)
Share-based payment settlement		^{2&3} (5 000)			³ (171 000)	(3)
Total comprehensive income						
- Profit (from (b))		32 869 394				(¹ / ₂)
- Other comprehensive income			(346 298) ⁴	500 000		(2)
Balance at 31 December 20.24	<u>243 678 000</u>	<u>89 644 394</u>	<u>(346 298)</u>	<u>500 000</u>	<u>-</u>	<u>(8)</u>
					Total	(2)

X1: Communication skills: Logical flow and conclusion

- ¹ (900 x 190 x ¹/₂) [1]
² Lowest fair value (cash option): cash 800 x 220 = 176 000 or equity 900 x 210 = 189 000 [2]
³ 176 000 – 171 000 (85 500 + 85 500) = 5 000 [1]
⁴ (2 500 000 – 2 846 298 (3 000 000 + 246 298 (from (b) – 400 000))) [1¹/₂]

PART II

- (a) Discuss in terms of IFRS 9 *Financial Instruments* whether the portfolio of bonds (refer to disclosure note 5) should be reclassified as financial assets measured at fair value through other comprehensive income.

In terms of IFRS 9.4.1.2A a financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.
- The contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding.

In terms of IFRS B4.1.3, although the objective of an entity's business model may be to hold assets in order to collect contractual cash flows, the entity need not hold all of those assets until maturity. Thus, an entity's business model can be to hold financial assets to collect contractual cash flows, even when sales of financial assets occur or are expected to occur in the future.

In terms of IFRS 9 B4.1.3A the business model may be to hold assets to collect contractual cash flows, even if the entity sells the financial assets when there is an increase in the credit risk. To determine whether there has been an increase in the credit risk, the entity considers **reasonable and supportable information**, including forward looking information. Selling a financial asset because it no longer meets the credit criteria specified in the entity's document investment policy is an example of a sale that has occurred due to an increase in credit risk.

In terms of IFRS 9 B4.1.4B a business model whose objective it is to both collect contractual cash flows and sell financial assets will typically involve a greater frequency and value of sales.

This is because the selling of the financial asset is integral to achieving the business model's objective, instead of being only incidental to it.

When determining cash flows that will be realised, it is necessary to consider the frequency, value and timing of sale in prior periods. (1/2)

Fitch Ratings are provided by banks and can be relied upon as being reasonable and used as support to assess the credit risk of the bonds, as they are external ratings done by a 3rd party. (1)

In terms of IFRS 9.4.4.1, when and only when an entity changes its business model for managing financial assets, it shall reclassify all affected financial assets in accordance with paragraphs 4.1.1 – 4.1.1.4.

GreenBottles did not change its business model, as contractual cash flows received is solely payments of principal and interest. (1/2)

It is not GreenBottles' intention to sell the bonds. The bonds are sold if the risk of recovery of contractual cash flows increases. (1/2)

GreenBottles sells the bonds only when there is an increase in the credit risk and the Fitch ratings go below F1, indicating that the risk of non-collection of contractual cash flows are high. Therefore, the sales of bonds are rather incidental to the credit risk increasing and not of greater frequency. (1 1/2)

Although the possibility exists of GreenBottles Ltd selling the bonds before maturity, it does not make it the objective of the business model to sell the assets. The sales are infrequent due to credit risk management or resulting from unanticipated funding needs. (1)

Therefore, the portfolio of bonds should not be classified to be measured at fair value through other comprehensive income, but should be measured at amortised cost (1)

Total (6 1/2)
Maximum (4)

- (b) Write an email to the financial director discussing your concerns in terms of IFRS 7 *Financial Instruments: Disclosures* and IFRS 9 *Financial Instruments* relating to the following notes provided:

1. Accounting policies
4. Financial assets measured at fair value through other comprehensive income
6. Trade and other receivables

To: Financial director
From: Financial manager
Re: Concerns regarding specific notes to the financial statements
Good day

As requested, I have reviewed the financials provided. Please find my concerns listed below:

1. Accounting policies	
In terms of IFRS 7.21, in accordance with paragraph 117 of IAS 1, an entity discloses its significant accounting policies comprising the measurement basis used in preparing the financial statements.	
Only the accounting policy of trade receivables is given - there is no policy note that includes other financial assets.	(1)
Trade receivables and allowances for credit losses policy note	
In terms of paragraph 5.5.15 of IFRS 9 an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:	
(a) trade receivables or contract assets that result from transactions that are within the scope of IFRS 15, and that	
(b) do not contain a significant financing component in accordance with IFRS 15	
As the trade receivables do not contain a significant financing component, the allowance for credit losses is the amount equal to lifetime expected credit losses (simplified approach) and, therefore, the policy note should be corrected and exclude the 12 month credit losses component.	(1)
The policy should not include interest calculations, as there is no significant financing component included in the trade receivables.	(1)
4. Financial asset at fair value through OCI	
In terms of IFRS 7.11 A, if an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of IFRS 9, it shall disclose	
(a) which investments in equity instruments have been designated to be measured at fair value through other comprehensive income.	
GreenBottles Ltd correctly stated that the investments are in shares of companies listed on the JSE, but did not name the companies.	(½)
(b) the reason for using this presentation alternative.	
No valid reason is provided for electing to measure the equity instruments at fair value through other comprehensive income.	(½)
(c) The fair value of each such investment at the end of the reporting period.	
The fair value of each of the investments is not disclosed as required by IFRS 7.	(½)
(d) Dividends recognised during the period.	
There is no disclosure regarding the dividends received by GreenBottles Ltd from the investments designated as measured through other comprehensive income.	(½)
6. Trade and other receivables	
GreenBottles Ltd needs to explain the changes in the loss allowance and the reasons for those changes. An entity shall provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss allowance in a table, showing separately the changes during the period for the loss allowance measured at an amount equal to lifetime expected credit losses for trade receivables, contract assets or lease receivables for which the loss allowance is measured in accordance with paragraph 5.1.15 of IFRS 7.25H(b)(iii)9.	
There is no reconciliation performed and disclosed for the lifetime expected credit losses from the opening to the closing balances.	(½)
In terms of IFRS 7.35G an entity shall explain the inputs, assumptions and estimation techniques used to recognise the expected credit losses. For this purpose, an entity shall disclose	
(a) The basis of inputs and assumptions and the estimation techniques used to	
(i) measure the lifetime expected credit losses	
(ii) determine whether a financial asset is a credit impaired financial asset	
(b) how forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomics information	

(c) changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.	
Greenbottles did not disclose any basis of input, assumptions and estimation, any forward-looking information that has been incorporated into the determination of the expected credit losses, any changes in the estimation technique or significant assumptions, and the reasons for those changes.	(1½)

I trust that you will find the above comments helpful.

Kind Regards

Financial Manager

Total (7)
X1: Communication skills: logic and conclusion (1)

QUESTION 6

20 marks

Shantui Construction Ltd (Shantui) is a South African company founded on 1 July 20.19. Shantui specialises in equipment used in the construction industry, such as bulldozers, industrial vehicles and concrete mixers. Shantui owns the equipment and leases the equipment to their customers operating in the construction industry in South Africa. Shantui's financial year end is 31 December.

The financial manager requested your assistance with the following transactions that have not been accounted for in the financial statements of Shantui for the year ended 31 December 20.24.

1. Foreign loan

On 1 September 20.24 Shantui borrowed CNY800 000 from its holding company in China. The currency of China is the Chinese yuan (CNY).

The loan from the holding company was utilised to finance the purchase of new bulldozers acquired in South Africa for a total amount of R1 500 000. The contract term of the loan agreement between Shantui and the holding company is four years. The loan agreement stipulates that annual capital instalments of CNY200 000 are payable on 31 August of each year, commencing on 31 August 20.25. The interest rate on the loan equals a market related interest rate of 9% per annum. Interest is payable six-monthly in arrears, commencing on 29 February 20.25.

On 1 October 20.24 the directors of Shantui expected adverse foreign currency fluctuations. On this date the directors of Shantui decided to enter into an eleven-month forward exchange contract (FEC) at a forward rate of R2 as part of their risk management strategy in respect of the first capital instalment of the loan.

Shantui does not apply hedge accounting.

The exchange rates at the relevant dates are as follows:

	Spot rate CNY1 = R	Forward rate CNY1 = R
1 September 20.24	1,95	
1 October 20.24	2,05	2,00 (11 months)
31 December 20.24	2,20	2,10 (8 months)
29 February 20.25	2,15	2,08 (6 months)
Average for period 1/09/20.24 – 31/12/20.24	2,02	
Average for period 1/01/20.25 – 29/02/20.25	2,10	

The purchase of the bulldozers, as well as the related depreciation, was correctly accounted for in the financial statements of Shantui Ltd for the year ended 31 December 20.24.

2. Allowance for expected credit losses

Shantui acquired an investment in listed bonds on 1 January 20.24. The listed bonds are held by Shantui within a business model whose objective is to collect contractual cash flows of interest and the principal amount. The classification and measurement of the investment in listed bonds were correctly accounted for in the financial statements of Shantui for the year ended 31 December 20.24.

The financial manager of Shantui is unsure about the calculation and measurement of the loss allowance for expected credit losses of the investment in listed bonds for the year ended 31 December 20.24. He asked for your assistance in this regard. The financial manager provided you with the following schedule from the company's actuary containing the information relevant to the bonds:

ABC Actuaries

Date: 5 January 20.25

Dear financial manager of Shantui Ltd

We assessed the investment in listed bonds acquired by you on 1 January 20.25 and determined the following:

Credit risk on 31 December 20.24	Low risk
Present value on 31 December 20.24 of contractual cash flows on the listed bonds in terms of the bond contract.	R920 520
Present value on 31 December 20.24 of expected contractual cash flows on the listed bonds over the contract term of the bonds, based on the risk or probability of default occurring over the expected life of the bonds.	R899 320
We estimate that there is a very low possibility of a credit loss occurring on the listed bonds.	
Probability of default occurring between 1 January 20.25 – 31 December 20.25	0,5%

In our assessment, above, we made use of reasonable and supportable information about past and current conditions, as well as forecasts on the listed bonds available to us. We trust the above calculation will assist with your accounting of the listed bonds.

Yours sincerely
Mrs. Jacobs

Additional information

- Assume all amounts are material.
- The normal income tax rate is 27%.

QUESTION 6
YOU HAVE 40 MINUTES TO ANSWER THIS QUESTION
REQUIRED

	Marks
(a) Prepare the journal entries for the financial year ended 31 December 20.24 in respect of transaction 1 in the records of Shantui Construction Ltd. Please note: • Ignore journal narrations. • Ignore any normal income tax implications. • Ignore the time value of money.	10
(b) Discuss the recognition and measurement of the expected credit losses on the investment in listed bonds in the financial statements of Shantui Construction Ltd for the year ended 31 December 20.24 in accordance with IFRS 9 <i>Financial Instruments</i>. Your answer should include calculations. <i>X1: Communication skills: logical argument</i>	9
Please note: • Ignore all Value Added Taxation (VAT) implications. • Round off all amounts to the nearest rand. • Your answer should comply with the IFRS Accounting Standards.	1

QUESTION 6 - Suggested solution

- (a) Prepare the journal entries for the financial year ended 31 December 20.24 in respect of transaction 1 in the records of Shantui Construction Ltd.

		Dr R	Cr R	
	1 September 20.24			
J1	Bank (SFP) (CNY800 000 x 1,95)	1 560 000		(1½)
	Foreign loan (SFP))		1 560 000	(½)
	Recognise loan received at spot rate			
	31 December 20.24			
J2	Foreign exchange difference (P/L)			(1½)
	[CNY800 000 x (2,20 – 1,95)]	200 000		(½)
	Foreign loan (SFP)		200 000	
	Remeasure foreign loan to spot rate at reporting date			
J3	Finance costs (P/L)			(1½)
	(CNY800 000 x 9% x 4/12 = 24 000 x 2,02)	48 480		
	Accrued interest (SFP)			(1½)
	(CNY800 000 x 9% x 4/12 x 2,20)		52 800	(1)
	Foreign exchange difference (P/L)	4 320		
	Year end accrual for interest for four months ended 31 December 20.24			
J4	FEC Asset (SFP) [CNY200 000 x (2,10 – 2,00)]	20 000		(1½)
	Fair value adjustment (P/L)		20 000	(½)
	Remeasure FEC (derivative financial instrument) at year end			
			Total	<u>(10)</u>

- (b) Discuss the recognition and measurement of the expected credit losses on the investment in listed bonds in the financial statements of Shantui Construction Ltd for the year ended 31 December 20.24 in accordance with IFRS 9 *Financial Instruments*. Your answer should include calculations.

Recognition

Shantui is required to recognise a loss allowance for expected credit losses on financial assets measured at amortised costs (IFRS 9.5.5.1). (1)

The investment in listed bonds is classified as a financial asset measured at amortised cost, since it is held within a business model whose objective is to collect contractual cash flows of interest and the principal amount (IFRS 9.4.1.2). (1)

At each reporting date, Shantui should assess whether the credit risk of listed bonds increased significantly since the initial recognition of the listed bonds (IFRS 9.5.5.9). (1)

This assessment of the increase in credit risk determines if a loss allowance equal to an amount of lifetime expected credit losses or 12-month expected credit losses is recognised on the listed bonds (IFRS 9.5.5.3 and IFRS 9.5.5.5). (1)

An entity may assume that the credit risk on a financial instrument has not increased significantly if the financial instrument is determined to have a low risk at reporting date (IFRS 9.5.5.10).

The actuary indicated that the listed bonds had a low risk on 31 December 20.24. For this reason, Shantui may assume that the credit risk on the listed bonds did not increase significantly since the initial recognition of the listed bonds. (½)

Based on the above, a loss allowance for expected credit losses equal to 12-month expected credit losses should be recognised on the investment in listed bonds. (½)

Measurement

In terms of IFRS 9.5.5.17 Shantui should measure the expected credit losses on the bonds in a way that reflects

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.

Even though the actuary determined that there is a very low possibility of a credit loss occurring on the listed bonds, the risk or probability that a credit loss may occur still has to be considered. (1)

The actuary used a probability weighted amount when calculating the expected cash flows of the listed bonds. (½)

- The time value of money.

The actuary used the contract term of the listed bonds to determine the present value of the expected contractual cash flows. (½)

- Reasonable and supportive information that was available to the actuary of Shantui without undue cost or effort about past events, current conditions and forecasts of future economic conditions. (1)

- The loss allowance for expected credit losses on the listed bonds, which are determined as follows:

	R	
Present value of contractual cash flows on 31 December 20.24	920 520	(½)
Present value of expected cash flows on 31 December 20.24	899 320	(½)
Lifetime expected credit losses	<u>21 200</u>	
Loss allowance equal to 12-month expected credit losses (21 200 x 0,5%)	<u>106</u>	(1)
	Total	(11)
	Maximum	(9)
		(1)

X1: Communication skills: logical argument (1)

QUESTION 7**15 marks**

Exclusive Clocks Ltd is a renowned clock maker in South Africa. Exclusive Clocks Ltd produces a range of beautiful clocks based on English clock making techniques and the latest technology in the industry. In order to produce authentic and high-quality clocks, Exclusive Clocks Ltd imports the necessary clock parts from England. The assembly of the clocks and engraving of dials take place at the assembly plant of Exclusive Clocks Ltd in Cape Town.

You have been asked to assist the accountant of Exclusive Clocks Ltd in finalising the financial statements of Exclusive Clocks Ltd for the year ended 30 June 20.24. The outstanding issues on which he requires your assistance are explained below:

1. Import of clock parts

On 31 December 20.23 Exclusive Clocks Ltd received an order from a major Johannesburg clock wholesaler for mantel clocks. To meet the required quantity of clocks for this order, Exclusive Clocks Ltd placed a non-cancellable order for the required clock parts from its supplier in England on 31 December 20.23 for an amount of £20 400. Due to the quantity of clock parts ordered and the risk it holds for foreign currency fluctuations, Exclusive Clocks Ltd entered into a four-month forward exchange contract (FEC) at a forward rate of £1 = R16,60 for the full amount payable. Exclusive Clocks Ltd entered into the FEC on the same date as the order was placed. The supplier in England requires settlement of the outstanding purchase price on 30 April 20.24. The clock parts were shipped free on board on 28 February 20.24 and arrived in Cape Town on 31 March 20.24.

The following exchange rates are applicable:

	Spot rate £1 = R	Forward rate £1 = R
31 December 20.23	16,25	16,60 (4 month FEC)
31 January 20.24	16,90	17,00 (3 month FEC)
28 February 20.24	17,45	17,20 (2 month FEC)
31 March 20.24	17,85	17,60 (1 month FEC)
30 April 20.24	18,10	

Exclusive Clocks Ltd does not apply hedge accounting in terms of IFRS 9.

2. Investment in listed bonds

On 1 July 20.22 Exclusive Clocks Ltd invested in listed bonds in Money Dreams Ltd. On this date Exclusive Clocks Ltd estimated the 12-month expected credit losses on the bonds at an amount of R35 000. The bonds were purchased on the following terms:

Maturity date	30 June 20.25
Coupon interest rate	6% per annum
Interest payment date	30 June
Nominal value per bond	R12 000
Number of bonds purchased	150
Redemption value	At nominal value

On 30 June 20.23 Exclusive Clocks Ltd assessed the credit risk of the bonds to estimate the expected credit losses at reporting date. During this assessment the directors of Exclusive Clocks Ltd obtained information that Money Dreams Ltd was in financial distress.

Exclusive Clocks Ltd determines that the credit risk of the bonds increased significantly since recognition of the bonds. Consequently, Exclusive Clocks Ltd measures the lifetime expected credit losses on 30 June 20.23 at R125 000.

On 30 June 20.24 Exclusive Clocks Ltd determines that the credit risk of the bonds has still increased significantly since initial recognition and measures the lifetime expected credit losses on this date at an amount of R165 000.

Additional information

- Assume all amounts are material.

QUESTION 7

YOU HAVE 30 MINUTES TO ANSWER THIS QUESTION

REQUIRED

	Marks
(a) Prepare the journal entries to account for the transactions relating to the importing of clock parts in the financial statements of Exclusive Clocks Ltd for the year ended 30 June 20.24. Please note: • Ignore journal narrations but include journal dates. • Ignore the time value of money.	11
(b) With reference to the investment in the listed bonds, disclose the changes in the loss allowance (allowance for expected credit losses) of the bonds in the financial statements of Exclusive Clocks Ltd for the year ended 30 June 20.24 in terms of IFRS 7.35H and the illustrated example contained in IFRS 7.IG20B. Comparative information is required. <i>X1: Communication skills: presentation and layout</i>	3
Please note: • Round all amounts off to the nearest rand. • Ignore normal income tax implications. • Ignore Value Added Taxation (VAT) implications. • Your answer must comply with IFRS Accounting Standards.	1

QUESTION 7 - Suggested solution

- (a) Prepare the journal entries to account for the transactions relating to the importing of clock parts in the financial statements of Exclusive Clocks Ltd for the year ended 30 June 20.24.

	Dr R	Cr R	
28 February 20.24			
J1 Inventory (SFP) (£20 400 x 17,45)	355 980		(1)
Creditor (SFP)		355 980	(½)
Recognise inventory at spot rate on transaction date			
30 April 20.24			
J2 Foreign exchange difference (P/L) (£20 400 x (18,10 – 17,45))	13 260		(1½)
Creditor (SFP)		13 260	(½)
Remeasure creditor to spot rate on settlement date (loss)			
J3 FEC asset (SFP) (£20 400 x (18,10 – 16,60))	30 600		(1½)
Fair value adjustment (P/L)		30 600	(½)
Remeasure FEC to fair value on settlement date (gain)			
J4 Creditor (SFP) (£20 400 x 18,10)	369 240		(1)
FEC asset (SFP)			
(12 240 + 18 360) or (£20 400 x (18,10 – 16,60))		30 600	(1½)
Bank (SFP) (£20 400 x 16,60)		338 640	(1)
Derecognition of FEC and payment of creditor			
		Total	<u>(11)</u>

- (b) With reference to the investment in the listed bonds, disclose the changes in the loss allowance (allowance for expected credit losses) of the bonds in the financial statements of Exclusive Clocks Ltd for the year ended 30 June 20.24 in terms of IFRS 7.35H and the illustrated example contained in IFRS 7.IG20B. Comparative information is required.

EXCLUSIVE CLOCKS LTD

NOTES OF THE YEAR ENDED 30 JUNE 20.24

15. Listed bonds – loss allowance

Loss allowance at 1 July 20.22

New bonds originated
Transferred to credit impaired financial assets
Changes in risk parameters

Loss allowance at 30 June 20.23

Changes in risk parameters

Loss allowance at 30 June 20.24

12-month expected credit losses R	Lifetime expected credit losses R	
-	-	
35 000		(½)
(35 000)	35 000	(1)
	90 000	(½)
-	125 000	
	40 000	(½)
-	165 000	(½)
	Total	<u>(3)</u>

X1: Communication skills: presentation and layout (1)

QUESTION 8

25 marks

You are the financial manager of Ultra Motors Ltd (Ultra Motors). Ultra Motors is a company that manufactures and sells vehicles and vehicle component parts. Most of Ultra Motors products are exported to Australia and America, although some products are sold in the local market. Ultra Motors manufacturing plants are located in Port Elizabeth and most of the exports are made via the Port Elizabeth harbour.

Ultra Motors' financial year end is 30 September, and you are currently compiling the financial statements for the year ended 30 September 20.22. These financial statements must be submitted for approval at the directors' meeting on 15 November 20.22.

Except for transaction 1 which was correctly accounted for, transactions 2 to 4 must still be accounted for in the financial statements of Ultra Motors for the year ended 30 September 20.22.

Transaction 1: Import of machine

On 1 September 20.22 a non-cancellable order was placed to import a machine from Australia. The purchase price of AUS\$ 99 000 was paid on 1 December 20.22. The machine was shipped free-on-board on 1 November 20.22. Ultra Motors obtained control of the machine on 1 November 20.22.

On 1 September 20.22 Ultra Motors entered into a forward exchange contract (FEC) for an amount of AUS\$ 99 000 in anticipation of the future import. The FEC expired on 1 November 20.22 and was not renewed.

Ultra Limited does not apply hedge accounting in terms of IFRS 9.

The exchange rates applicable were as follows:

	Spot rate	2 months FEC rate	1 months FEC rate
	1 AU\$\$=R	1 AU\$\$=R	1 AU\$\$=R
1 September 20.22	8,00	8,18	8,20
30 September 20.22	8,11	8,34	8,32
1 November 20.22	8,30	8,48	8,45
1 December 20.22	8,35	8,58	8,54

Transaction 2: Loan incurred

Ultra Motors borrowed R1 000 000 from Altex Ltd (Altex) on 1 October 20.7. Interest amounting to R100 000 is payable annually on 30 September in respect of the loan. The repayment terms state that the loan capital must be repaid at a premium of R200 000 on 30 September 20.22 (to compensate for the low nominal interest rate compared to a market-related interest rate on a similar loan). You may assume that the loan and the related interest were treated correctly in the accounting records of Ultra Motors up to and including 30 September 20.22. The loan amounted to R1 200 000 in Ultra Motors' books on 30 September 20.22.

During September 20.22 Ultra Motors was in the process of expanding its business operations. To reserve funds for the expansion, Ultra Motors renegotiated the terms of the repayment of the loan with Altex. Ultra Motors proposed the following terms of the redemption of the loan:

- To redeem the loan by issuing 120 000 preference shares of Ultra Motors to Altex on 30 September 20.22.
- Preference dividend payments are within the discretion of Ultra Motors.
- The preference shares will be converted on 30 September 20.24, into the ratio of two ordinary shares for every one preference share held.

Altex accepted the proposal on the basis of growing their investment portfolio. The loan was redeemed on 30 September 20.22 by Ultra Motors issuing 120 000 preference shares to Altex. The redemption of loan has not been accounted for by Ultra Motors. You may assume that the preference shares are correctly classified as equity instruments in terms of IAS 32 *Financial Instruments: Presentation* and that the total fair value thereof amounted to R1 400 000 on 30 September 20.22.

SARS regards the redemption of the loan (by the issue of preference shares) as capital in nature and, therefore, allows no tax deductions in respect of the redemption of the loan.

Transaction 3: Issue of convertible debentures

To generate additional cash, Ultra Motors issued a total of 100 000 R10 debentures at a discount of 20% on 1 January 20.22. The debentures carry a coupon interest rate of 12% per annum, which is payable annually on 31 December. The compulsory convertible debentures will be converted into Ultra Motors ordinary shares in the ratio of one debenture for two ordinary shares on 31 December 20.28. There is no option for cash settlement. A market-related interest rate on similar debentures without conversion rights amounted to 9% per annum on 1 January 20.22. No entries have been made in respect of this transaction. Assume that SARS accepts the amortised cost of the debentures as the tax base of the debentures. Ultra Motors received a tax directive from SARS indicating that future taxable profits on the debentures will be taxed at 27%.

Transaction 4: Investment in shares

Ultra Motors invested in 200 000 ordinary shares of Speedfast Ltd (Speedfast) on 1 October 20.21, which represents 10% of the issued shares of Speedfast. Ultra Motors is dependent on Speedfast for the supply of its products and, therefore, regards this investment as a long-term strategic investment. On initial recognition of the investment in Speedfast, the management of Ultra Motors elected to recognise changes in the fair value of the equity instrument in other comprehensive income using the mark-to-market reserve.

The investment was acquired at fair value when the share price of Speedfast's ordinary shares was R6,20 per share. Transaction costs directly attributable to the acquisition of the investment amounted to R23 000. The fair value of Speedfast's ordinary shares on 30 September 20.22 amounted to R8,45 per share. For tax purposes the transaction costs are included in the tax base of the investment.

Additional information

- The issued share capital and retained earnings balance of Ultra Motors on 1 October 20.21 amounted to R3 000 000 and R2 340 000, respectively.
- Ultra Motors' profit after tax amounted to R3 765 000 for the year ended 30 September 20.22, before considering the redemption of the loan in transaction 2 and transactions 3 and 4.
- The normal income tax rate is 27% and capital gains tax inclusion rate is 80%.

QUESTION 8

YOU HAVE 50 MINUTES TO ANSWER THIS QUESTION

REQUIRED

	Marks
(a) Prepare the journal entries for the financial years ended 30 September 20.22 AND 30 September 20.23 in respect of transaction 1 in the records of Ultra Motors Ltd. Please note: • Ignore depreciation journals in respect of the machinery. • Journal narrations are not required. • Ignore any normal income tax implications. • Ignore the time value of money.	11
(b) Prepare the statement of changes in equity of Ultra Motors Ltd for the year ended 30 September 20.22. The total column and comparative figures are not required.	12
<i>X1: Communication skills: presentation and layout</i>	2

QUESTION 8 - Suggested solution

- (a) Prepare the journal entries for the financial years ended 30 September 20.22 AND 30 September 20.23 in respect of transaction 1 in the records of Ultra Motors Ltd.

		Dr R	Cr R	
	20.22 year			
	30 September 20.22			
J1	FEC asset (SFP) [(8,32 – 8,18) x \$99 000]	13 860		(1½)
	Fair value adjustment (P/L)		13 860	(½)
	Fair value adjustment of FEC at year end			
	20.23 year			
	1 November 20.22			
J2	Fair value adjustment (P/L) [(8,30 – 8,32) x \$99 000]	1 980		(½)
	FEC asset (SFP)		1 980	(1½)
	Fair value adjustment of FEC on expiry date.			
J3	Machine (SFP) [8,30 x \$99 000]	821 700		(1)
	Creditors (SFP)		821 700	(½)
	Recognition of asset and creditor on transaction date			
J4	Bank (SFP) [(8,30 – 8,18) x \$99 000]	11 880		(1½)
	FEC asset (SFP)		11 880	(½)
	Settlement of FEC on expiry date			
	1 December 20.22			
J5	Foreign exchange differences (P/L)	4 950		(1½)
	[(8,35 – 8,30) x \$99 000]			
	Creditors (SFP)		4 950	(½)
	Restatement of creditor to spot rate on payment date			
J6	Creditor (SFP) [99 000 x 8,35]	826 650		(1)
	Bank (SFP)		826 650	(½)
	Settlement of creditor			
			Total	<u>(11)</u>



EXAM TECHNIQUE

When preparing journals, always date your journals. This demonstrates to the examiner that you understand the occurrence of the specific dates of transactions.

- (b) Prepare the statement of changes in equity of Ultra Motors Ltd for the year ended 30 September 20.22.

ULTRA MOTORS LTD

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 SEPTEMBER 20.22

	Ordinary share capital R	Preference share capital R	Retained earnings R	Convertible debentures equity component R	Mark-to market reserve R	
Balance at 1 October 20.21	3 000 000	-	2 340 000	-		(1)
Total comprehensive income for the year						
- profit [C1]	-	-	3 535 240	-		(5½)
- other comprehensive income [C3]	-	-	-	-	334 768	(3½)
Issue of preference shares [C2]	-	1 400 000	-	-		(1)
Issue of convertible debentures [C4]	-	-	-	143 114 ¹		(1)
Balance at 30 September 20.22	3 000 000	1 400 000	5 875 240	143 114	334 768	
Total						(12)

X1: Communication skills: presentation and layout (2)

$$^{1}196\,046 [C4] \times 73\% = 143\,114$$

CALCULATIONS

C1. Profit for the year

Profit after tax (given)	3 765 000	[½]
Loss on redemption of loan (IFRIC 19) [C2]	(200 000)	[1]
Interest on the liability portion of the compulsory convertible debentures [C4]	(40 767)	[3]
Tax on the interest (40 767 x 27%)	11 007	[1]
	<u>3 535 240</u>	<u>[5½]</u>

C2. Loss on redemption of loan

IFRIC 19

Loan outstanding (given)	1 200 000	[½]
Preference shares issued at fair value	(1 400 000)	[½]
Loss on redemption of loan (P/L)	<u>(200 000)</u>	<u>[1]</u>

The loss is not deductible for tax purposes, since it is capital in nature. It is, therefore, considered in the profit **after** tax for 20.22 as it has no impact on the income tax expense for 20.22.

C3. Mark-to-market reserve

Fair value on 1 October 20.21 ($200\,000 \times R6,20$)	1 240 000	[½]
Capitalise transaction costs	<u>23 000</u>	[½]
	1 263 000	
Fair value on 30 September 20.22 ($200\,000 \times R8,45$)	1 690 000	[½]
Fair value adjustment	<u>427 000</u>	
Tax ($R427\,000 \times 80\% \times 27\%$)	<u>(92 232)</u>	[1]
Mark-to-market reserve (net of tax)	<u>334 768</u>	
		<u>[2½]</u>

C4. Convertible debentures

Present value of the liability

N	=	7 years	[½]
I	=	9% p.a. (market interest rate)	[½]
PMT	=	$(100\,000 \times R10) \times 12\% = 120\,000$	[½]
FV	=	0 (no cash option)	[½]
COMP PV	=	603 954	
			<u>[2]</u>
Financial liability		603 954	
Equity component (balancing figure)		<u>196 046</u>	[1]
Proceeds ($100\,000 \times 10 \times 80\%$)		<u>800 000</u>	
Interest income for the year ended 30 September 20.22			
1 AMORT (interest) $R54\,356 \times 9/12$		<u>40 767</u>	[1]
OR			
$(603\,954 \times 9\%) = 54\,356 \times 9/12$		<u>40 767</u>	
			<u>[4]</u>

QUESTION 9**40 marks**

You are a recently qualified chartered accountant. Ms Sane Morobeng CA(SA), the audit committee chairperson of ItsAlright Ltd (IA), has approached you regarding outstanding matters relating to the company.

IA specialises in the manufacturing and selling of security products and is listed on the Johannesburg Stock Exchange (JSE). The company invests surplus funds in various financial instruments, which are expected to yield a reasonable return. Sane provided you with the following extracts and additional information from the draft financial statements of IA:

1. Draft statement of financial position for the year ended 31 December 20.24

	Notes	20.24 R	20.23 R
ASSETS			
Non-current assets			
Property, plant and equipment		7 452 892	8 990 456
Investment properties		3 000 000	3 000 000
Financial asset at amortised cost	(a)	1 320 000	-
		<u>11 772 892</u>	<u>11 990 456</u>
Current assets			
Inventory		2 654 300	1 908 456
Trade receivables	(c)	1 456 991	1 345 892
Cash and cash equivalents		4 839 921	2 456 789
		<u>8 951 212</u>	<u>5 711 137</u>
Total assets		<u>20 724 104</u>	<u>17 701 593</u>
EQUITY AND LIABILITIES			
Equity			
Ordinary share capital		1 000 000	1 000 000
Retained earnings		14 343 225	12 533 134
Share-based payment reserve	(d)	532 800	-
Total equity		<u>15 876 025</u>	<u>13 533 134</u>
Non-current liabilities			
Debentures at fair value	(b)	350 000	-
Financial liabilities at fair value	(e)	3 350 000	3 000 000
		<u>3 700 000</u>	<u>3 000 000</u>
Current liabilities			
Trade and other payables		1 143 579	1 168 459
Expected credit loss allowance	(a)	4 500	-
		<u>1 148 079</u>	<u>1 168 459</u>
Total liabilities		<u>4 848 079</u>	<u>4 168 459</u>
Total equity and liabilities		<u>20 724 104</u>	<u>17 701 593</u>

Notes**(a) Financial asset at amortised cost**

On 1 January 20.24 IA purchased debentures at its fair value of R1 440 000. IA did not pay any transaction costs. The debenture issuer pays annual coupon interest of R120 000 on 31 December of each year. The debentures will be redeemed on 31 December 20.28 at an amount of R1 500 000. IA correctly classified the debentures as a financial asset measured at amortised cost.

On 1 January 20.24 IA estimated the 12-month expected credit losses at an amount of R3 000. On 31 December 20.24 there was a significant increase in the credit risk of the debentures since its initial recognition. However, there was no default in the payment of interest for the year ended 31 December 20.24. The debentures were not credit impaired at any stage. On 31 December 20.24 the 12-month expected credit losses were estimated to be R4 500 and the lifetime expected credit losses on the debentures amounted to R128 500.

On 31 December 20.24 the following journals in respect of the purchased debentures were posted:

	Dr R	Cr R
1 January 20.24		
Financial assets at amortised cost (SFP)	1 440 000	
Bank (SFP)		1 440 000
Recognition of financial asset		
31 December 20.24		
Bank (SFP)	120 000	
Financial assets at amortised cost (SFP)		120 000
Recognition of interest received		

(b) Debentures at fair value

On 31 December 20.24 IA issued 25 000 convertible debentures at a coupon rate of 9% per annum. The debentures were issued at fair value with a face value of R14 per debenture. The maturity date of the debentures is 31 December 20.28. Each debenture is convertible at the option of the holder into three ordinary shares in IA. If the debentures are not converted, they will be settled in cash at face value. A market related interest rate on 31 December 20.24 for similar debentures without conversion rights is 14% per annum. Transaction costs incurred and paid amounted to R10 000.

On 31 December 20.24 the following journal in respect of the debentures issued was posted:

	Dr R	Cr R
31 December 20.24		
Bank (SFP)	350 000	
Debentures at fair value (SFP)		350 000
Recognition of debentures issued		

(c) Trade receivables

On 31 December 20.24 IA had a portfolio of trade receivables which amounted to R1 456 991. The trade receivables do not have a significant financing component in terms of IFRS 15 *Revenue from Contracts with Customers*. No expected credit losses were recognised, since the balance is expected to be recovered in full.

(d) Share-based payment reserve

On 1 January 20.24 IA granted share options to each of its 150 employees. These options will vest at the end of 20.26, provided that the employees remain in IA's service and that the share price of IA increases. The current share price of IA is R135. IA requires the following share price increases for the indicated share options (per employee) to vest:

Required share price increase	Share options per employee
Between 5% and 8% per annum	800
Between 9% and 15% per annum	900
Over 15% per annum	1000

The fair value per option was R12 at grant date, which has accounted for the possibility that the share price will increase by 6%. At the end of 31 December 20.24 it was estimated that the share price will increase by more than 9% before the end of the vesting period. At the end of 31 December 20.24 two employees had resigned, and it is expected that only one employee will resign during the following two years.

On 31 December 20.24 the following information was considered with the calculation of the share-based payment reserve (equity):

	Result
Number of employees (150 - 2)	148
Number of share options (148 employees x 900 share options)	133 200
Measured at fair value at grant date (133 200 share options x R12)	R1 598 400
Recognition of the share-based payment expense for the first year (R1 598 400/3)	R532 800

(e) Financial liability at fair value

IA raised R2 000 000 through the issue of 1 000 000 10% bonds on 1 January 20.23. IA designated these bonds at 1 January 20.23 as measured at fair value through profit or loss, since this will eliminate an accounting mismatch. Transaction costs incurred by IA amounted to R10 000. Coupon interest is due and payable annually on 31 December. On 31 December 20.23 the bonds had a fair value of R3 000 000. The fair value gain caused by the increase in IA's credit risk is R400 000. The increase in the fair value movement of the liability of R1 200 000 [R3 000 000 - (R2 000 000 - R200 000)] was recognised in profit or loss. On 31 December 20.24 the bonds had a fair value of R3 500 000. There has been no change in the credit risk of the bonds. It is the policy of IA not to recognise the interest expense on the bonds separately.

2. Additional information: acquisition of new machine

On 15 July 20.24 IA purchased a machine that will be used to manufacture security drones, a new innovative product. On 1 August 20.24 IA placed a non-cancellable order to purchase the machine from a supplier in Europe at a cost of €60 000. On the same date IA entered into a six-month forward exchange contract (FEC) to buy €60 000 to protect the company against unfavourable fluctuations in the rand/euro exchange rate.

The machine was delivered to IA on 15 September 20.24. Control of the machine passed to IA on delivery date. IA does not apply hedge accounting in terms of IFRS 9 *Financial Instruments*. The following exchange rates were applicable:

Date	Spot rate €1 =	Forward exchange rate expiring on 31 January 20.25 €1 =
15 July 20.24	R16,12	-
1 August 20.24	R16,17	R16,23
15 September 20.24	R16,15	R16,24
12 October 20.24	R16,16	R16,27
31 October 20.24	R16,13	R16,25
31 December 20.24	R16,10	R16,22
31 January 20.25	R16,11	R16,22

QUESTION 9

YOU HAVE 80 MINUTES TO ANSWER THIS QUESTION

REQUIRED

	Marks
(a) Prepare all the correcting and any outstanding journal entries in respect of the purchased debentures (note (a)) and the issued convertible debentures (note (b)) in the financial records of ItsAlright Ltd for the year ended 31 December 20.25. Please note: - Journal narrations are not required. - Journal should be dated. - Ignore taxation.	14
(b) Discuss any concerns you may have in relation to the measurement of: (i) Trade receivables at 31 December 20.24 (note (c)). (ii) Share-based payment reserve at 31 December 20.24 (note (d)). Please note: - Support your discussion with calculations where appropriate. - You are not required to provide correcting journal entries. - You are not required to refer to the <i>Conceptual Framework for Financial Reporting</i>. - Ignore taxation. <i>X1: Communication skills: logical argument</i>	8
(c) With regard to the financial liability (bonds) measured at fair value in note (e): (i) Discuss the correct recognition of the movement in the fair value of the bonds in the financial records of ItsAlright Ltd. Your answer should also mention the impact on each affected line item in the financial statements of ItsAlright Ltd for the year ended 31 December 20.24. <i>X1: Communication skills: logical argument</i>	6
(ii) Provide the journal entries to account for the financial liability in the financial records of Its Alright Ltd for the year ended 31 December 20.24, assuming that the prior period error has already been corrected. Please note: - Journal narrations are not required. - Ignore any taxation.	4

	Marks
(d) Provide the journal entries to account for the acquisition of the new machine (refer to point 2 additional information) in the financial records of ItsAlright Ltd for the year ended 31 December 20.24. Please note: • Journal narrations are not required. • Ignore depreciation journals in respect of the machinery. • Ignore any taxation. • Ignore the time value of money. Please note: • Round off all amounts to the nearest rand, except for the effective interest rate, which should be rounded off to four decimals. • Your answer must comply with IFRS Accounting Standards.	6

QUESTION 9 – Suggested solution

- (a) Prepare all the correcting and any outstanding journal entries in respect of the purchased debentures (note (a)) and the issued convertible debentures (note (b)) in the financial records of ItsAlright Ltd for the year ended 31 December 20.25.

	Dr R	Cr R	
Debentures financial asset – 31 December 20.24			
J1 Financial assets at amortised cost (SFP)	130 032		(1)
Interest income (P/L) [C1]		130 032	(4)
Recognition of interest received			
J2 Expected credit losses (P/L)	124 000		(½)
Allowance for expected credit loss (SFP)			
(R128 500 – R4 500)		124 000	(1½)
Recognition of expected credit losses for the period			
Debentures liability – 31 December 20.24			
J3 Debentures at fair value (SFP)	350 000		(½)
Financial liability at amortised cost: Debentures (SFP) [C2.1]		299 010	(2½)
Equity component of convertible debentures (SCE) [C2.1]		50 990	(1)
Recognition of debenture liability			
J4 Financial liability at amortised cost: Debentures (SFP) [C2.2]	8 543		(2)
Equity component of convertible debentures (SCE)	1 457		(1)
Bank (SFP)		10 000	(½)
Capitalise transaction cost			
		Total	(14½)
		Maximum	(14)

CALCULATIONS

C1. Interest income on purchased debentures

N	5	[1]
PV	R1 440 000	[1]
FV	R1 500 000	[½]
PMT	R120 000	[½]
COMP: I/Y = 9,0292%		

Interest income

1 Amort or (R1 440 000 x 9,0292%)	130 020	[1]
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C2. Convertible debentures

C2.1 Financial liability component

N	4	[½]
I/Y	14%	[½]
PMT (25 000 x R14 x 9%)	R31 500	[½]
FV (250 000 x R14)	R350 000	[½]
COMP PV	R299 010	

Components

Proceeds (25 000 x R14)	350 000	[½]
Present value of financial liability	299 010	[½]
Equity component	50 990	

C2.2 Transaction costs to be capitalised

Liability component (299 010/350 000 x 10 000)	8 543	[1½]
Equity component (balancing)	1 457	[½]
Total	<u>10 000</u>	

(b) Discuss any concerns relating to the measurement of:**(i) Trade receivables at 31 December 20.24 (note (c)).**

No expected credit losses were recognised for trade receivables: (1)

- Since the financial asset is a trade receivable in terms of IFRS 15 and does not involve a significant financing component, the expected credit losses must be accounted for under the simplified approach (IFRS 9.5.5.15). (1)
- IA should construct a reliable provision matrix to determine expected credit losses for the portfolio of trade receivables (IFRS B5.5.35). (1)
- This provision matrix should be based on the expected default rates per ageing category of trade receivables (IFRS B5.5.35).
- Using the provision matrix, a loss allowance equal to the lifetime expected credit losses on the portfolio of trade receivables should be calculated (IFRS 9.5.5.15). (1)

(ii) Share-based payment reserve at 31 December 20.24 (note (d)).

The number of share options that will ultimately vest was incorrectly calculated: (1)

- The number of share options used was 900. This is incorrect, as the number of share options that will vest is dependent on a market condition, i.e., the share price target and it should not be revised (IFRS 2.21). (1)
- The number of options should be 800, as the market condition was considered when estimating the fair value of share options on the grant date. (1)
- The number of share options that will vest was not calculated correctly, as only the employees that have actually left (2) were considered. In terms of IFRS 2.20, the number of employees expected to leave should also be considered, i.e., reducing the number of employees by a further one. (2)
- The correct calculation is R470 400 (800 x (150 – 2 – 1) x R12)/3. An amount of R62 400 (532 800 – 470 400) should be used to reduce the share-based payment reserve balance in equity and employee benefit cost recognised in profit or loss. (2)

Total (11)

Maximum (8)

X1: Communication skills: logical argument (1)

- (c) Discuss the correct recognition of the movement in the fair value of the bonds in the financial records of ItsAlright Ltd. Your answer should also mention the impact on each affected line item in the financial statements of ItsAlright Ltd for the year ended 31 December 20.24.

The bonds of IA are measured at fair value with any movement in the fair value thereof recognised in profit or loss. (1)

However, any movement in the fair value of the bonds that is attributable to changes in credit risk should be recognised in other comprehensive income. [IFRS 9.5.7.7] (2)

For the financial year ended 31 December 20.23, the movement in the fair value of the bonds was recognised in profit and loss, which included a portion amounting to R400 000 which should have been recognised in other comprehensive income. (2)

This represents a material (according to the information provided, all amounts should be regarded as material) error and should be corrected retrospectively (IAS 8.42) (1)

The affected line items in the financial statements for the year ended 31 December 2024 should be adjusted as follows:

20.23 Comparative figures

Statement of profit or loss and other comprehensive income:

The fair value gain in other comprehensive income will increase with R400 000 (Cr). (1)

The fair value gain recognised in profit or loss will decrease with R400 000 (Dr). (1)

Statement of financial position:

The retained earnings closing balance will decrease with R400 000 (Dr) (1)

Statement of changes in equity:

The mark-to-market reserve balance will increase with R400 000 (Cr) (1)

20.24 Figures

The retained earnings opening balance 2023 will decrease with R400 000 (Dr) (1)

The mark-to-market reserve opening balance will increase with R400 000 (Cr) (1)

Net effect on equity will be nil.

No effect of the fair value of the liability

Total (12)
Maximum (6)

X1: Communication skills: logical argument (1)

- (ii) Provide the journal entries to account for the financial liability in the financial records of Its Alright Ltd for the year ended 31 December 20.24, assuming that the prior period error has already been corrected.

		Dr R	Cr R	
J1	31 December 20.24			
	Financial liability (debentures) (SFP) (10% x R2 000 000)	200 000		(1½)
	Bank (SFP)		200 000	(½)
	Recognise interest paid to debenture holders			
J2	Fair value loss (P/L)	700 000		(1½)
	Financial liability (debentures) (SFP)			
	(R3 500 000 – (R3 000 000 – R200 000))		700 000	(½)
	Recognise fair value loss			
			Total	<u>(4)</u>

- (d) Provide the journal entries to account for the acquisition of the new machine (refer to point 2 additional information) in the financial records of ItsAlright Ltd for the year ended 31 December 20.24.

		Dr R	Cr R	
	15 September 20.24			
J1	Machinery (SFP) (16,15 x 60 000)	969 000		(1)
	Foreign creditor (SFP)		969 000	($\frac{1}{2}$)
	Recognise machinery at spot rate			
J2	31 December 20.24			
	Foreign creditor (SFP)			
	((16,15 -16,10) x 60 000)	3 000		($1\frac{1}{2}$)
	Foreign exchange difference (P/L)		3 000	($\frac{1}{2}$)
	Remeasure foreign creditor to spot rate at reporting date			
J3	Fair value adjustment (P/L)			
	((16,23 – 16,22) x 60 000)	600		(2)
	FEC Asset (SFP)		600	($\frac{1}{2}$)
	Remeasure FEC to fair value at year end			
			Total	<u>(6)</u>

IGNORE VAT

You are a newly appointed accounting specialist at Soyiso Ngcanga Inc. ("Soyiso"). Soyiso is an accounting advisory firm operating from Sunninghill. The partner heading the accounting division approached you to assist their accounting clients in finalising the preparation of the financial statements to be submitted for approval to the respective board of directors. He has summarised the issues relating to various clients, all of whom apply IFRS Accounting Standards and have a 29 February 20.24 year end.

Issue 1: Income tax

The financial manager of Mthentu Ltd ("Mthentu") went on leave to tour East Africa. Before her departure she prepared the deferred tax calculation and the income tax note for the year ended 29 February 20.24. She had the documents printed and informed the chief financial officer that the documents were stored in the photocopy room. While studying the documents, the chief financial officer realised that the documents did not print properly and that some parts were illegible. He realised this after the financial manager had already departed on her tour. The documents, as well as any relevant information, are given below:

Income tax expense**Major components of tax expense**

20.24
R

SA Normal tax

Current tax

- Current year

A

Deferred tax

B

Foreign tax

80 000

?

Tax reconciliation

Accounting profits

2 560 000

Income tax at 27%

691 200

Dividends

(28 000)

License fines

7 500

Unprovided assessed loss benefit utilised

?

Effect of different tax rate on foreign income

(4 000)

?

Deferred tax calculation

	Carrying amount R	Tax Base R	Temporary differences at 100% or 80% R	Deferred tax at 27% asset/(liability) R
28 February 20.23				
Taxable temporary differences	905 000	870 000	35 000	(9 450)
Unused tax loss	0	500 000	(35 000)	9 450
			<u>0</u>	<u>0</u>
29 February 20.24				
Taxable temporary differences	984 000	894 000	90 000	(24 300)
Taxable temporary differences (through OCI) (200 000 x 80%)	1 200 000	1 000 000	160 000	(43 200)
			<u>250 000</u>	<u>(67 500)</u>

The above deferred tax calculation takes all relevant information into account, and you may assume that the amounts are correct. At the end of 20.23 financial year, the company was uncertain whether there would be future taxable income.

Issue 2: Foreign loan

On 1 September 20.21, Flagstaff Ltd ("Flagstaff") borrowed £400 000 from Amabritani Bank, based in the United Kingdom. The foreign loan was used to fund the purchase of plant for the construction of a new N2 bridge along the coast from Lusikisiki to Bizana. The loan agreement stipulates that annual capital instalments of £200 000 are payable each year, commencing on 31 August 20.22. The loan bears interest at a market related rate of 9% per annum. Interest is payable annually in arrears, commencing on 28 February 20.22.

The exchange rates at the relevant dates are as follows:

	Spot rate £1 = R
1 September 20.21	23,40
28 February 20.22	23,55
31 August 20.22	23,58
28 February 20.23	23,65
31 August 20.23	23,80
Average for period 1/9/20.21 – 28/2/20.22	23,25
Average for period 1/3/20.22 – 28/2/20.23	23,22
Average for period 1/3/20.23 – 31/8/20.23	23,30

In order to alleviate some cash flow pressure on the company, the terms of the outstanding loan were re-negotiated during the year ending on 29 February 20.24. The renegotiated terms required Flagstaff to settle the last instalment on 31 August 20.23 by issuing 180 000 special class A shares (ordinary shares with no voting rights or rights to dividends) to Amabritani. The fair value of each special class A share was R28 per share on 31 August 20.23. No journal entries have been processed with regards to this transaction in the 20.24 financial year. You can assume that the transaction was correctly accounted for in the 20.22 and 20.23 financial year.

Issue 3: Investment in Bonds

Msikaba Ltd ("Msikaba") purchased 10 000 listed bonds from Bondvest Ltd ("Bondvest") on 1 March 20.22 at a fair value of R42 per bond. Transaction costs amounted to R15 500. Coupon interest of 8% calculated on the face value of the bonds is paid annually in arrears. The bonds will be redeemed at their face value of R50 each on 28 February 20.27. Msikaba's business model is to hold the investment in bonds to collect contractual cash flows as well as to sell the investment with equal prominence. The fair values of the bonds were as follows:

Date	Fair value per bond R	Assessed credit risk	12-month expected credit losses R	Lifetime expected credit losses R
1 March 20.22	42	Low	14 580	62 500
28 February 20.23	48	Low	16 820	79 500
29 February 20.24	45	High (not credit-impaired)	18 250	82 000

Below are the journals that were recorded for the bonds in the 20.23 financial period; No journal entries have been processed for the 20.24 financial period:

		Dr R	Cr R
	1 March 20.22		
J1	Investment in bonds (SFP) (10 000 x 42)	420 000	
	Transaction costs (P/L)	15 500	
	Bank (SFP)		435 500
	Recognise investment and transaction costs		
J2	Expected credit loss (P/L)	14 580	
	Allowance for expected credit losses (SFP)		14 580
	Recognition of 12-month expected credit loss		
	28 February 20.23		
J3	Bank (SFP) (10 000 x 50 x 8%)	40 000	
	Investment in bonds (SFP)		40 000
	Recognise coupon interest received		
J4	Investment in bonds (SFP)	60 000	
	Fair value adjustment (P/L)		
	(R48 – 42) x 10 000		60 000
	Adjust for increase in fair value		
J5	Expected credit loss (P/L)	2 240	
	Allowance for expected credit losses (SFP)		
	(16 820 – 14 580 [J2])		2 240
	Adjust allowance for expected credit losses		

During the current year, the chief financial officer of Msikaba requested the financial accountant to prepare an error note as there was an audit finding from Q&A Registered Auditors regarding the journal processed in the 20.23 financial year. Below is the error note prepared by the financial accountant:

NOTES FOR THE YEAR ENDED 29 FEBRUARY 20.24

2. Prior period error

	20.24 R
Effect in Statement of Comprehensive Income	
Decrease in interest income	50 247
Increase in fair value gain (45-42 x 10 000)	(30 000)
Increase in other expenses	15 500
Increase in mark-to-market reserves (OCI)	34 253
Increase in allowance for expected credit loss (OCI)	16 820
Effect in Statement of Financial Position/Statement of Changes in Equity	
Increase in Investment in bonds (SFP) (R440 000-R480 000)	40 000
Decrease in allowance for expected credit loss (SFP)	16 820
Increase in mark-to-market reserves (SCE)	(34 253)
Increase in allowance for expected credit loss (SCE)	(16 820)

Due to Msikaba's tight deadline to finalise the financial statements for board approval, the CFO requested that you review the error note for him.

CASE STUDY 1

REQUIRED

YOU HAVE 80 MINUTES TO COMPLETE THE CASE STUDY

QUESTION 1

	Marks
(a) Calculate the amount that should be disclosed as a current tax in the income tax expense note of Mthentu Ltd for the year ended 29 February 20.24. (Issue 1)	7
(b) Show the separate components of the tax expense that should be disclosed under deferred tax in the income tax note of Mthentu Ltd for the year ended 29 February 20.24. Indicate clearly whether the amounts should be added or subtracted in the note. (Issue 1)	3
<i>X1: Communication skills: presentation and layout</i>	1
(c) Prepare the journal entries, with dates, to account for the foreign loan in the accounting records of Flagstaff Ltd for the year ended 29 February 20.24. (Issue 2)	12
Please note: Journal narrations are not required.	
(d) Prepare an email to the financial accountant in which you critically evaluate the prior period error of Msikaba Ltd, in terms of IAS 8 <i>Basis of Preparation of Financial Statements</i> (Issue 3) . Provide reasons to support your answer. Calculations are required.	16
<i>X1: Communication skills: presentation and layout</i>	1
Please note: - Your answer must comply with IFRS Accounting Standards. - Ignore current and deferred tax implications.	
Total	40

CASE STUDY 1

QUESTION 1 – Suggested solution

- (a) Calculate the amount that should be disclosed as a current tax in the income tax expense note of Mthentu Ltd for the year ended 29 February 20.24.

Mthentu current tax

	20.24	
	R	
Profit before income taxes	2 560 000	(1)
Foreign income - not taxable ins RSA ((80 000 + 4 000) / 27%)	(311 111)	(1½)
Non-taxable items (28 000 / 27%)	(103 704)	(1)
Non-deductible items (7 500 / 27%)	27 778	(1)
Taxable temporary difference (90 000 – 35 000)	(55 000)	(1)
	<u>2 117 963</u>	
Prior year unused tax loss	(500 000)	(1)
Taxable income	<u>1 617 963</u>	
Tax at 27%	<u>436 850</u>	<u>(½)</u>
		<u>(7)</u>

- (b) Show the separate components of the tax expense that should be disclosed under deferred tax in the income tax note of Mthentu Ltd for the year ended 29 February 20.24. Indicate clearly whether the amounts should be added or subtracted in the note

Mthentu deferred tax

	20.24	
	R	
Movement in temporary differences ((90 000 - 35 000) x 27%)	14 850	(1)
Recognition of unused tax loss previously not recognised ((500 000 - 35 000) x 27%)	(125 550)	(1)
Unused tax loss utilised (500 000 x 27%)	135 000	(1)
	Total	<u>(3)</u>
		<u>(1)</u>

X1: Communication skills: Presentation and layout



DISCUSSION

In 20.24 the entity had a taxable income; therefore it is not necessary for management to estimate whether there will be future taxable income. However, in 20.23, the entity had a tax loss of R500 000, and the company (management) was uncertain whether there would be future taxable income; hence, the deferred tax on the unused tax loss was limited to taxable temporary differences.

- (c) Prepare the journal entries, with dates, to account for the foreign loan in the accounting records of Flagstaff Ltd for the year ended 29 February 20.24. (Issue 2)

		Dr R	Cr R	
	Foreign loan			
	31 August 20.23			
J1	Foreign exchange difference (P/L) [$\text{£}200\,000 \times (23,80 - 23,65)$]	30 000		[2]
	Foreign loan (SFP)		30 000	[1]
	<u>Remeasure foreign loan to spot rate at settlement date</u>			
J2	Finance cost (P/L) ($\text{£}200\,000 \times 9\% \times 6/12 \times 23,30$)	209 700		[2½]
	Accrued expense (SFP) ($\text{£}200\,000 \times 9\% \times 6/12 \times 23,80$)		214 200	[1½]
	Foreign exchange difference (P/L)	4 500		[1]
	<u>Recognise finance cost</u>			
J3	Accrued expense (SFP)	214 200		[1]
	Bank (SFP) ($\text{£}200\,000 \times 9\% \times 6/12 \times 23,80$)		214 200	[1]
	<u>Settlement of finance cost</u>			
J4	Foreign loan (SFP) ($\text{£}200\,000 \times 23,80$)	4 760 000		[1½]
	Share Capital (SCE) ($180\,000 \times 28$)		5 040 000	[1½]
	Loss on settlement of loan (P/L)	280 000		[1]
	<u>Settlement of loan</u>			
			Total	[14]
			Maximum	[12]

- (d) Prepare an email to the financial accountant in which you critically evaluate the prior period error note, in terms of IAS 8 Basis of Preparation of Financial Statements (issue 3). Provide reasons to support your answer.

From: specialist@soyiso.co.za
To: financialaccountant@msikabaa.co.za
Subject: IAS 8 error note
Date: 26 March 20.24

Dear Financial Accountant,

Please see my comments below relating to the prior period error note you have prepared,

In terms of IAS 8.42, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery. Q&A Registered auditors raised the finding in 20.23 and the CFO is correcting the error before the board authorised 20.24 financial statements.

(1)

The entity should disclose the nature of the prior period error (IAS8.49); the current note does not include the nature of the error. The note should disclose that the bonds purchased and the loss allowance relating to the bonds on 1 March 20.22 were incorrectly measured and classified; the bonds should have been accounted at fair value through other comprehensive income. The note should also state the fact that the error has been corrected retrospectively, and the impact of the correction.

(3)

Material prior period errors are corrected retrospective by restating the comparative amounts in which the error occurred (IAS8.42). The current note corrects the error in 20.24, which is incorrect, the correction should be in 20.23, which is the year in which the error occurred.

(1)

Effect in Statement of Comprehensive Income

The increase in other expense is incorrect, it should be a decrease because Msikaba incorrectly expensed transaction cost of R15 500 which then reduced the company profit or loss. Decreasing other expenses will cancel the transaction cost initially expensed which should have been capitalised as the business model for the investment is through other comprehensive income. (2)

Increase in fair value gain is incorrectly treated and calculated. In 20.23 Msikaba recognised a gain of R60 000 which is the difference between fair value at year end of R48 and purchase price of the bond of R42. In the prior period error note, this amount is taken out of profit or loss as the gains would go through OCI. Your calculation on the note is incorrect as you compared 20.24 fair value of R45 not 20.23 fair value of R48. (2)

The effect of a decrease in interest income is incorrect. It should be an increase in interest income because interest was not provided under investment through profit or loss. In terms of IFRS9.5.1.1 transaction costs are capitalised to the investment and effective interest rate determined gives rise to a recognition on interest income the amount of R50 247 (C1.1) is correctly calculated. (5)

Expected credit loss allowance is recognised in other comprehensive income for financial asset measured through other comprehensive income (IFRS9.5.5.2) - therefore increase in mark to market reserves and increase in allowance for expected credit loss is correctly disclosed on the error note. (2)

Effect in Statement of Financial Position

Increase in bond investment, effect and amount is correct, the increase is based on the adjusted carrying amount which is a purchase price, interest income and less the coupon rate and fair value of R48 at 28 February 20.23. IFRS9.5.7.10 (1)

Expected credit loss is recognised in the statement of changes in equity for financial asset measured through other comprehensive income (IFRS9.5.5.2) - therefore increase in mark to market reserves and increase in allowance for expected credit loss is correctly disclosed on the error note. (2)

Please contact me if you need clarity.

Kind regards
Specialist

Total	<u>(19)</u>
Maximum	<u>(16)</u>
<i>X1: Communication skills: logical argument and layout</i>	<u>(1)</u>

CALCULATIONS

C1.1 Interest income on bonds

Calculation of effective interest

SHARP EL-738		HP10BII		
1. 2 nd F C.CE	(Clear all)	1. 2 nd F C	(Clear all)	
2. 1	P/Y	2. 1	P/YR	
3. 5	N	3. 5	N	[½]
4. R500 000 ¹	FV	4. R500 000 ¹	FV	[½]
5. R40 000 ²	PMT	5. R40 000 ²	PMT	[½]
6. (R435 500) ³	PV	6. (R435 500) ³	PV	[1½]
7. COMP I/Y	11,54%	7. I/YR	11,54%	

¹ (10 000 x R50) = R500 000

² (10 000 x R50 x 8%) = R40 000

³ (10 000 x 42 + R15 500) = R435 500

Amortisation bond: 28 February 20.23

	R
Gross carrying amount	435 000
Interest income (effective interest rate)	50 247
Interest coupon rate	(40 000)
Investments in bonds	<u>445 247</u>